

N.A.S.D. AWARD

NATIONAL ASSOCIATION OF SECURITIES DEALERS

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In the Matter of the Arbitration Between

Name of Claimant

Bruce E. Babula c/f Stephen Babula

96-03303

Name of Respondents

Janney Montgomery Scott Inc.  
William J. Pearce

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CASE SUMMARY

In a case filed with the National Association of Securities Dealers Regulation, Inc. on August 1, 1996, claimant Bruce E. Babula c/f Stephen Babula ("claimant"), who appeared Pro Se, alleged that respondents Janney Montgomery Scott, Inc. ("JMS") and William J. Pearce ("Pearce") sold him a product fraudulently or in error. Claimant further alleged that in July 1993, Pearce who was well aware of his custodial goals and risk tolerance, called him with unprecedented urgency and strongly advised him to sell Eaton Vance National Municipals Fund (the "Fund") in his custodial account. Claimant also alleged that he sold the shares and then Pearce advised him to purchase mortgage backed securities which he stated were from "tranches", which would return the principal by 1997. Claimant asserted that based on Pearce's continued recommendation and reassurance, he made two purchases. Claimant further asserted that he would not have opted to switch investments if he had not been assured of the safe and timely return of principal.

Claimant also asserted that as time passed he noted that the principal return rate was at marked variance with what had been promised. Claimant contended that in January of 1996, he had a series of fruitless telephone conversations with Pearce. Claimant further contended that Pearce admitted that JMS monthly statements overvalued the true market value of the securities. Claimant also contended that a letter he received from JMS stated that "At the time these securities were stated to have a three to five year average life span and that two of the three were immediate paying bonds". Claimant alleged that consultation in 1996 with another investment firm yielded the information that these were in fact high-risk tranches and were projected as eight to twelve year bonds as of 1996.

Respondents JMS and Pearce (collectively referred to as "respondents") through their representative and counsel Paula Shaffner of the law firm Saul, Ewing, Remick & Saul located in Philadelphia, Pennsylvania maintained claimant's claim relates to Collateralized Mortgage

Obligations ("CMO's), which he had purchased for his own and four custodial accounts. Respondents further maintained in spring of 1993, Pearce was assigned claimant's account when their old registered representative left JMS. Respondents also maintained that once Pearce was assigned the account he spoke with claimant to gather information about him, his wife and children, their investment objectives, financial situation and risk tolerance. Respondents contended that claimant spoke with Pearce regularly about his investments which included the Fund. Respondents further contended that claimant was concerned about the effect of interest rates

on the value of those investments. Respondents also contended that claimant understood quite clearly the effect of interest rates on the value of securities and routinely checked with Pearce to inquire what the "dollar cost" was and where interest rates might be going.

Respondents maintained that because the Fund had 20-25 year maturities and claimant's concern about the effect of interest rates on those positions, Pearce and claimant discussed liquidating the Fund. Respondents further maintained that during this period of time, Pearce and claimant did not discuss mortgage backed securities. Respondents also maintained that when the interest rates made it attractive to sell the Fund, Pearce advised claimant that it would be a good time to sell and that claimant agreed wholeheartedly. Respondents contended that the decision to sell evolved slowly and Pearce never made any such urgent telephone calls to claimant. Respondents further contended that claimant was instrumental in all decisions regarding the sale and purchase of any security.

Respondents also contended that the concept of the CMO's was raised as a method for investing the money that would otherwise earn a lower rate of interest in the money market account, where the funds from the sale were deposited. Respondents maintained that at the time the investment was made, the CMO's were stated to have a three to five year average life, two of which were immediate paying bonds. Respondents further maintained that Pearce thoroughly explained the mortgaged-backed securities to claimant, specifically, the pricing assumptions, the interest rate and the effect of prepayment of the mortgage loans as discussed in detail. Respondents also maintained that Pearce discussed prepayments of mortgage loans and how they are measured relative to a prepayment standard or model and described the Public Securities Association standard prepayment model ("PSA"). Respondents contended that at the time the CMO's were purchased, it was an appropriate investment for claimant's accounts.

Respondents further contended that the CMO's were purchased in claimant's accounts on three different dates and that claimant has not lost money on any of these investments. Respondents also contended that the investments had paid interest on a monthly basis and two of the CMO's paid principal for almost two years. Respondents maintained that at this time, two of the CMO's stopped paying principal and the average life of the bonds was extended. Respondents further maintained that these changes occurred as a result of a decrease in the PSA speed, which changed the maturities of the CMO's. Respondents also maintained that claimant continues to receive interest on the investments and, while principal is not currently being prepaid on some of the CMO's, the distribution of principal and interest is guaranteed by government-backed agencies. Respondents contended that no misrepresentation was made to claimant at any time.

Respondents further contended that this case involves simply the fact that the principal will not be repaid in the time period that claimant originally expected it to be.

**RELIEF REQUESTED**

Claimant Bruce Babula c/f Stephen Babula requested (1) that on December 31, 1996, JMS purchase from him without fee enough bonds at par value to reduce the factor outstanding to .67; (2) that on December 31, 1997, JMS purchase enough bonds at par value to reduce the factor outstanding to .33; (3) that on December 31, 1998, JMS purchase all outstanding bonds at par; (4) if JMS desires to purchase all outstanding bonds at par immediately that would be acceptable to him.

Respondents JMS and Pearce requested that the claims of claimant be dismissed in their entirety.

**AWARD**

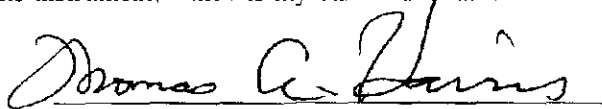
Pursuant to Rule 10302 of the Code of Arbitration Procedure, a single Public Arbitrator, Thomas A. Harris was selected to review that matter in controversy between the parties set forth in submissions to Arbitration signed by claimant Bruce Babula on July 30, 1996 and by respondents JMS on September 27, 1996 and Pearce on October 2, 1996 as required by Rules 10301 and 10302 of the Code of Arbitration Procedure.

And, the Arbitrator, having considered the proof of the parties, had decided and determined in full and final resolution of the issues submitted for determination as follows:

1. Respondents JMS and Pearce be and hereby are jointly and severally liable and shall within thirty days of service of this award repurchase, without fee or commission, the collateralized mortgage obligations involved in this claim, at the gross prices paid by claimant, less any intervening distributions of principal.
2. The \$125.00 filing fee previously deposited with the National Association of Securities Dealers Regulation, Inc. by claimant shall be retained by NASD Regulation, Inc. Respondents JMS and Pearce be and hereby are jointly and severally liable and shall pay claimant the sum of \$125.00 as reimbursement of the filing fee.

**AFFIRMATION**

I, **Thomas Harris, Esq.**, do hereby affirm upon my oath as arbitrator that I am the individual described herein who executed this instrument, which is my oath and award.

  
Thomas A. Harris, Esq.

Date of Decision: March 31, 1997