

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of

Department of Enforcement,

Complainant,

vs.

Stephen W. Wilson
Thousand Oaks, CA,

Respondent.

DECISION

Complaint No. 2007009403801

Dated: December 28, 2011

Respondent recommended unsuitable mutual fund switch transactions to customers, engaged in unauthorized trading and unauthorized discretionary trading, and falsely represented to his firm the reasons for mutual fund switches and that customer purchases were unsolicited. Held, findings and sanctions modified.

APPEARANCES

For the Complainant: Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Peter Brown Dolan, Esq.

DECISION

Stephen W. Wilson (“Wilson”) appeals the Hearing Panel’s decision in this matter pursuant to FINRA Rule 9311.¹ In that decision, the Hearing Panel found that Wilson violated Section 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110 for making fraudulent misrepresentations and omissions related to recommended investments; NASD Rules 2310 and 2110 and IM-2310-2 for recommending unsuitable mutual fund switches; NASD Rules 2510(b) and 2110 and IM-2310-2 for engaging in unauthorized trading and unauthorized discretionary trading; and NASD Rules 3110 and 2110 for causing inaccurate books and records by providing his firm with false reasons for mutual fund switches and falsely representing to his firm that certain customer mutual fund

¹ The conduct rules that apply in this case are those that existed at the time of the conduct at issue.

transactions were unsolicited. The Hearing Panel barred Wilson for the fraud violation and imposed two additional bars for recommending unsuitable transactions and engaging in unauthorized trading. After a complete review of the record and for the reasons discussed herein, we modify the Hearing Panel's findings of violation and the sanctions imposed.

I. Background

A. Wilson's Employment History

Wilson entered the securities industry in 1992 and has been associated with several FINRA member firms. Wilson's conduct relevant to this decision occurred during the time when he was associated with Prudential Securities, Inc. ("Prudential") and Wachovia Securities, LLC ("Wachovia" or the "Firm").² Wilson was registered with Wachovia from August 1999 until April 2005 as a general securities representative. Wilson was last registered with a FINRA member firm in April 2010.

B. Procedural History

On June 19, 2009, Enforcement filed a five-cause amended complaint against Wilson. The first count of the complaint alleged that Wilson violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110 by misrepresenting and failing to disclose to customers material facts about investments that he was recommending to them. The second count alleged that Wilson recommended unsuitable mutual fund switches to several customers, in violation of NASD Rules 2310 and 2110 and IM-2310-2. The third count alleged that Wilson engaged in unauthorized trading in several customers' accounts, in violation of NASD Rule 2110 and IM-2310-2. The fourth cause of the complaint alleged that Wilson exercised discretionary authority in customer accounts without authorization, in violation of NASD Rules 2510(b) and 2110. The fifth cause alleged that Wilson caused his Firm's books and records to be inaccurate when he falsely represented to the Firm the reasons for several customers' mutual fund switches and erroneously reported that customers' mutual fund switches were unsolicited, in violation of NASD Rules 3110 and 2110.

² Wilson was associated with Prudential from May 1997 to August 1999. Beginning in August 1999, Wilson was associated with several firms that, through a series of mergers and acquisitions, became part of Wachovia. Wilson was associated with Everen Securities, Inc. ("Everen"), from August 1999 until November 1999, when Wilson's registration was transferred to First Union Securities, Inc. after that firm acquired Everen. Wilson's registration was then transferred to Wachovia when it and First Union merged in June 2002. The misconduct discussed herein encompasses Wilson's registration at all of these firms. For the purpose of our discussion, any reference to Wachovia shall include Everen and First Union.

The Hearing Panel found Wilson liable for the alleged violations, with the exception of several categories of omissions. The Hearing Panel imposed three separate bars upon Wilson for the fraud, the unsuitable recommendations, and the unauthorized trading. This appeal followed.³

II. Facts

A. Wilson's Recommendation of Mutual Funds

The primary focus of Wilson's securities business was recommending and effecting mutual fund transactions for employees of GTE Corporation who were eligible or approaching eligibility to receive lump-sum retirement distributions.⁴ To obtain the business of GTE employees, Wilson gave sales presentations geared specifically to the employees and the retirement options available to them in hotel banquet rooms at which complimentary meals were served. He also attended retirement parties for departing GTE employees, passing out business cards to attendees, and he recruited existing customers to refer others to him, giving out \$50 restaurant gift certificates for each referral that opened an account with him.

Wilson referred to himself as a "Retirement Planning Specialist" on business cards and marketing materials that he provided to prospective customers.⁵ For example, in the "Retirement Planning Analysis" brochure that he prepared for customers, Wilson stated, "[b]eing a Retirement Planning Specialist, handling Lump-Sum Distributions has become more than an area of specialty, it has become virtually all I do." As of 2002, Wilson stated that he had "worked with over 1100 GTE/Verizon employees in helping them sort out their retirement options" and had over 300 current customers.

Wilson's approach for soliciting prospective customers was substantially the same for all of the GTE employees referenced in this decision. Wilson, together with the prospect, would complete a "fact finder," a single-page sheet that Wilson designed. Wilson used this form to determine information about the prospective customer, including the prospect's retirement income, debts, spending habits, and anticipated activities post-retirement. Wilson then prepared a "Retirement Planning Analysis" brochure for each customer. The format and content of the brochure were essentially the same for each customer. Wilson reviewed the customer's financial

³ Enforcement's appellate brief exceeded the prescribed page limit by one page. We grant Enforcement's request to file an oversized brief.

⁴ In June 2000, GTE and Bell Atlantic merged to form Verizon Communications. *See* "Verizon GTE Corporation Corporate History," http://www.fcc.gov/wcb/armis/-carrier_filing_history/COSA_History/gttc.htm. GTE and Verizon are referred to in this decision as "GTE."

⁵ This designation originated from a six-week course and test on retirement planning that Wilson took while Dean Witter Reynolds employed him between 1992 and 1997.

situation and included ten mutual funds, which Wilson recommended for the specific client. In the brochure, Wilson observed that “it’s easier for me to ‘look after things’ when most of my clients with similar objectives and needs own the same assets (but with different proportions).” A customer’s ability to take regular withdrawals from retirement funds before age 59 ½ was central to Wilson’s Retirement Planning Analysis.⁶

Wilson used a computer program called Morningstar Principia Pro as a tool in selecting the ten mutual funds for each client. The ten categories of mutual funds included corporate bonds, U.S. government securities, utilities, large-cap growth, large-cap value, large-cap foreign, small-cap U.S., small-cap foreign, mid-cap value, and cash. Wilson stated in the customer’s Retirement Planning Analysis that he chose fund families from which to select funds based on “their integrity in the industry as well as the large number of different funds in their respective families (this will allow us to make subtle changes within the portfolio without charge or limitation).” Within the fund families, he selected funds that were at least five years old and managed continuously by the same fund manager for at least two years.

B. The Customers

The allegations against Wilson pertain to his activities between April 1998 and April 2005 with respect to the following customers who opened retirement accounts with him and invested in the Class B mutual fund shares that he recommended.⁷ These customers all testified at the hearing below.

⁶ At the relevant time, Internal Revenue Code (“IRC”) § 72(t) allowed taxpayers in certain circumstances to take IRA distributions before age 59 ½ without incurring an early withdrawal penalty.

⁷ The SEC explained mutual fund share classes as follows:

[T]he major cost associated with purchasing Class A shares is a sales charge known as a “front-end load.” . . . This sales charge is paid when the shares are bought and it is deducted from the amount invested (effectively reducing the quantity of mutual fund shares purchased). By contrast, Class B shares have a back-end sales charge—the [contingent deferred sales charge or] CDSC—but no front-end load. . . . The CDSC is collected from the investor when the mutual fund shares are sold rather than at the time of purchase. . . . Typically, the CDSC is reduced for each year that an investor holds Class B shares, phasing out entirely after a certain number of years. Class C shares also impose a CDSC, . . . but that charge is usually eliminated after those shares have been held for more than one year.

- Mr. JT, a GTE equipment installer, went to work for the company after finishing high school and serving in the Air Force. He retired from GTE in January 1999 at age 49. Mrs. JT started working for GTE in 1969 as a repair operator. She retired in May 1999 at age 51. The JTs invested approximately \$950,000 with Wilson in 1999.
- DL went to work at GTE in 1967 as a long-distance operator and thereafter worked in a variety of capacities until she retired in 1999 at age 53. She invested her lump sum payment of \$291,000 and \$109,000 from a GTE savings plan with Wilson.
- GS worked at GTE from 1966 to 2002 as a lineman, cable splicer, and installer. He was 58 when he retired. He invested his lump sum of \$275,000 with Wilson.
- DP installed, repaired, and maintained business telephone systems for GTE. He started at the company in 1969 after two years of college and four years of service in the Navy. He retired in 1999 at age 55. He subsequently invested \$454,000 with Wilson.
- EW started working for GTE in 1973 processing residential and business orders. She retired in 1999 at age 59. She invested approximately \$239,000 with Wilson.
- CG started working at GTE in 1965. Throughout his career with the company, he worked as a cable splicer, installer, and repairman. He retired in 1999 at age 54. He invested approximately \$380,000 with Wilson.
- RJ was an equipment maintainer at GTE. RJ began working at GTE in 1966 after receiving an associate's degree and serving in the Navy. He retired in 2002 at age 54. RJ invested \$370,000 with Wilson.
- EP started working at GTE in 1964 and retired in 1999 at age 54. While employed by GTE, EP refurbished and installed equipment and spliced cables. He invested approximately \$575,000 with Wilson.
- NA worked at GTE from 1969 to 1999 in installation and repair and other capacities. He was 53 when he retired from the company. He invested with Wilson approximately \$300,000 that he received upon retirement.
- GB was hired by GTE in 1967 as a clerical worker and thereafter was employed installing computer lines and data equipment. He retired from GTE in 1998 at age 52. He and his wife invested a total of about \$438,000 with Wilson.
- MR started working at GTE in 1967 as a cable splicer, and later worked in installation and repair. He retired from GTE in 1999. He invested about \$247,000 with Wilson.

These customers were unsophisticated investors and conservative in their investment objectives (e.g., they wanted to protect their principal). Most of these customers made

[cont'd]

Scott Epstein, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at *7 n.8 (Jan. 30, 2009) (internal citations omitted), *aff'd*, 416 F. App'x 142 (3d Cir. 2010).

withdrawals from their retirement accounts pursuant to IRC § 72(t).⁸

C. The Declining Stock Market and the Mutual Fund Switches

Beginning in March 2000, the stock market fell into a period of sustained decline. Wilson subsequently began receiving calls from customers concerned about the declining value of their investments. Wilson initially recommended that his customers “stay the course” and “hang in there.” But in 2001 and 2002, Wilson recommended and executed a total of 359 mutual fund switching transactions in the accounts of 12 of his customers.⁹ The switches were from Class B shares to Class C shares in all but two instances, and many transactions involved switching from one fund family into a different family of funds.¹⁰

According to Wilson, the purpose of the switches was to put the customers in “a place where we can go for a short period of time, typically one year, and catch our breath a little bit and find out where this market is going.” In selecting the funds into which he switched the customers, Wilson used the same evaluation process as the one he had used in making his initial selection of funds. He ran the Morningstar Principia Pro analysis and made a new set of fund recommendations. Wilson deemed none of the equity funds from his initial selection for the customers worth holding and all were liquidated. In several of the customers’ accounts, Wilson sold U.S. government and bond funds and used the proceeds to buy aggressive growth funds. Wilson testified that he did not believe that the customers’ risk tolerances had changed, but he made these investment strategy changes in order “to recover quicker” from the market’s decline and “to turn this thing around.”

D. Authorization of the Switches and the Aftermath

Wilson testified that he discussed the switches with his customers before he effected the transactions. Customers GS, DP, EP, GB, MR, and Mr. JT agreed that they had authorized the switches, and GS, DP, and Mr. JT testified that they knew about the fees associated with doing so. Other customers disagreed with Wilson’s version of events. Customers DL and EW disputed that they had approved of the transactions or that they even knew about them until after they received their confirmation statements. Customer NA testified that he discussed with

⁸ GS planned to continue working elsewhere after his retirement from GTE and testified that IRC § 72(t) did not apply to his circumstances. DP testified that because he earned enough from his own business, he did not take distributions pursuant to IRC § 72(t).

⁹ The switches occurred in the accounts of the following customers: NA, Mr. and Mrs. GB, CG, DL, EP, DP, MR, GS, Mr. and Mrs. JT, and EW.

¹⁰ The two exceptions occurred in NA’s and EW’s accounts, for which Wilson bought Class A shares. In addition to the Class A share transactions, Wilson effected switches from Class B to C shares in 16 transactions in NA’s account and 19 transactions in EW’s account.

Wilson replacing one poor performing fund, but Wilson sold all of NA's mutual fund shares in ten funds and reinvested the majority of the proceeds in Class C shares in different funds.¹¹

As a result of the switches, the 12 customers together incurred CDSCs totaling \$84,240.¹² Wilson received commissions of \$36,516 on the purchases effected in the switch transactions. While the payment of CDSCs resulted in fewer of the customer's assets under management, the switches also resulted in Wilson receiving higher trailer fees on the customers' mutual fund holdings.

The customers entered into settlement agreements with Wilson as a result of a related arbitration action against him.

III. Discussion

For the reasons discussed below, we affirm the Hearing Panel's finding that Wilson engaged in unsuitable mutual fund switches, unauthorized trading, and discretionary trading without authorization, and caused his Firm's books and records to be inaccurate. We dismiss the Hearing Panel's findings related to fraudulent misrepresentations and omissions.

A. Wilson's Unsuitable Mutual Fund Switches

We affirm the Hearing Panel's finding that Wilson engaged in unsuitable mutual fund switches in the accounts of 12 customers,¹³ in violation of NASD Rules 2310 and 2110 and IM-2310-2.¹⁴ NASD Rule 2310(a) requires that a representative in recommending the purchase, sale, or exchange of any security to a customer "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." Compliance with the suitability rule requires a registered representative to "make a customer-specific determination of suitability and . . . tailor his recommendations to the customer's financial profile and investment objectives." *F.J. Kaufman & Co.*, 50 S.E.C. 164, 168 (1989).

¹¹ With NA's sales proceeds, Wilson bought Class C shares in six funds and Class A shares in one fund.

¹² Mr. and Mrs. JT incurred \$17,964 in CDSCs. EP and DP each incurred CDSCs in excess of \$10,000. DL incurred charges of more than \$9,000, as did Mr. and Mrs. GB. The remaining five customers incurred the following in CDSCs: CG - \$7,903; GS - \$5,368; NA - \$5,139; EW - \$4,398; and MR - \$3,492.

¹³ See *supra* note nine for a complete list of the 12 customers.

¹⁴ IM-2310-2(b)(3) explains that trading in mutual fund shares on a short-term basis is not proper trading and "on its face may raise the question of Rule violation."

The recommendation also must be consistent with a customer's best interests. *See Epstein*, 2009 SEC LEXIS 217, at *40. In making a suitability determination with respect to the mutual fund switches, Wilson was required to evaluate "the net investment advantage of any recommended switch from one fund to another" because mutual fund switches "may be difficult to justify if the financial gain or investment objective to be achieved by the switch is undermined by the transaction fees associated with the switch." *See NASD Notice to Members 94-16*, 1994 NASD LEXIS 18, at *5 (Mar. 1994); *NASD Notice to Members 95-80*, 1995 NASD LEXIS 109, at *9 (Sept. 1995).

The SEC and the NAC have held that a pattern of mutual fund switching violates NASD Rule 2310(a) and thereby creates a rebuttable presumption of unsuitability. *See Kenneth C. Krull*, 53 S.E.C. 1101, 1104 (1998) ("Mutual fund shares generally are suitable only as long-term investments and cannot be regarded as a proper vehicle for short-term trading, especially where such trading involves new sales loads."), *aff'd*, 248 F.3d 907 (9th Cir. 2001); *Dep't of Enforcement v. Epstein*, Complaint No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *67-68 (FINRA NAC Dec. 20, 2007); *Dep't of Enforcement v. Respondent*, Complaint No. C07010037, 2003 NASD Discip. LEXIS 16, at *21-23 (NASD NAC May 13, 2003). As we have explained:

A pattern of switches from one fund to another by several customers of a registered representative, where there is no indication of a change in the investment objectives of the customers and where new sales loads are incurred, is not reconcilable with the concept of suitability. Where such a pattern is established, it is incumbent upon the registered representative that recommended such switches to demonstrate the unusual circumstances which justified what is a clear departure from the manner in which mutual fund investments are normally made.

Epstein, 2007 FINRA Discip. LEXIS 18, at *67 (internal quotations and citations omitted).

Wilson made wholesale changes to customers' holdings, irrespective of earlier having espoused the benefit of investing in mutual funds in large fund families in order to "make subtle changes within [a customer's] portfolio without charge." He failed to recommend less expensive fund alternatives within the same fund family, which would have avoided triggering new CDSC holding periods for Class B shares. Instead, he liquidated the customers' equity fund holdings and used the proceeds to buy shares in equity funds in other fund families. And in some instances, he also liquidated holdings in U.S. government securities and bond funds and used the proceeds to buy shares in aggressive growth funds, despite there being no indication of a change in the customers' conservative investment objectives. Wilson testified that he made the determination to move into growth funds in the hopes of "turn[ing] this thing around" and viewed this only as a short-term, "defensive" strategy. Wilson also believed that it was necessary to change fund families in order to best address his customers' concerns of market losses and therefore did not view the recommendation to buy in a different fund family as

inconsistent with his earlier representations. In Wilson's opinion, if "the XYZ fund family had a stinker for their growth fund, they are probably not going to be too excelling [sic] elsewhere[]]. Checked that enough that I'm satisfied that the fund family is in a little bit of disarray. I would have better luck just starting fresh with C shares."¹⁵

Wilson made no discernable effort to determine whether the purportedly better performance of the funds into which he switched his customers would justify the costs associated with the switches. In failing to do so, Wilson ignored his "obligation to avoid increasing the costs that his . . . customers pay." See *Dep't of Enforcement v. Belden*, Complaint No. C05010012, 2002 NASD Discip. LEXIS 12, at *14-15 (NASD NAC Aug. 13, 2002) (finding unsuitable mutual fund switching when representative recommended mutual fund purchases that were incongruent with the customer's ability to purchase funds with similar investment objectives in the same fund families without incurring a sales charge), *aff'd*, 56 S.E.C. 496 (2003). Wilson's mutual fund switch recommendations subjected the customers to fees and longer holding periods, or denied them lower operating expenses to which they would have been entitled with the passage of time. Specifically, the transactions caused the customers to incur more than \$84,000 in CDSCs and lose the benefits associated with holding Class B shares until they were convertible into Class A shares, which carried lower annual costs resulting from such conversions. The switches also caused them to lose the time that they would have accumulated towards being able to make such conversions. Even if the customers were to purchase Class B shares again after the one-year Class C shares' holding period expired, they would have been starting anew with respect to the Class B holding periods. As Wilson acknowledged, Class C shares "never graduate to A shares." Moreover, while the CDSC charge associated with Class C shares would disappear after one year, the higher operating costs associated with the recommended Class C shares would continue indefinitely.

Wilson argues that the customers agreed to the switches or even initiated the process with him to "stop the bleeding" in their accounts. "A recommendation is not suitable merely because the customer acquiesces in the recommendation." *Epstein*, 2007 FINRA Discip. LEXIS 18, at *66 n.28 (internal quotation omitted). Rather, Wilson was obligated to act in the customers' best interests. See *NASD Notice to Members 95-80*, 1995 NASD LEXIS 109, at*2; see also *Dep't of Enforcement v. Frankfort*, Complaint No. C02040032, 2007 NASD Discip. LEXIS 16, at *31 (NASD NAC May 24, 2007) (finding that representative was obligated to disclose a hedge fund's losses in order for the customer to have a complete understanding of the recommended investment). Even if some of the customers agreed to the switches, they did so without a complete description of the charges associated with switching share classes and the potential

¹⁵ Wilson's actions, however, belie his professed rationale. In many instances, Wilson switched customers from Oppenheimer and Alliance Class B shares into Class C shares of different Oppenheimer and Alliance funds. In addition, Wilson was recommending that new customers invest in Class B shares at the same time that he was recommending that existing customers switch into Class C shares.

effect of the switches on their investment return.¹⁶ For example, Wilson did not disclose the CDSCs to certain customers. Customers CG, EP, and GB understood that Wilson was going to invest in different funds to improve the performance in their accounts, but did not know there would be any financial cost in doing so. Customer MR testified that Wilson said nothing about any fees to move from Class B shares to Class C shares. Wilson told other customers that there was a fee but not the actual amount. Customer GS testified that Wilson told him that he was better off paying the fees to move into the Class C shares, but Wilson did not tell him that doing so would cost GS more than \$5,000 in CDSCs. Wilson inaccurately told Mr. JT that there would be a CDSC of one percent when the actual fee was closer to two percent. Wilson also did not inform several customers of the cost saving option of switching within the family of funds they already owned.

Wilson argues that Enforcement offered no evidence to show that the switches were unsuitable in light of the market decline or that he had “any better option” in order to “stop the bleeding” in his customers’ accounts. Wilson claimed, in executing the switches, that he was responding to the “tech wreck” and “looking for ways to turn this thing around.” Wilson’s argument does not recognize that it is *his* burden to show that the switches were suitable in light of the pattern shown. As the SEC has recognized, “a generally declining market” and a fund’s “poor performance” are not sufficient reasons to rebut the presumption against the suitability of mutual fund switching. *See Charles E. Marland & Co.*, 45 S.E.C. 632, 634-35 (1974); *see also Epstein*, 2007 FINRA Discip. LEXIS 18, at *73 n.32; *cf.*, *Richard G. Cody*, Exchange Act Rel. No. 64565, 2011 SEC LEXIS 1862, at *39-40 (May 27, 2011) (rejecting representative’s desire for yield to compensate for customer’s purported increased withdrawals as rationale for deviating from customer’s objectives). We find that Wilson has not produced the evidence necessary to show the unusual circumstances which would justify the switching recommendations. We therefore affirm the finding that Wilson violated NASD Rules 2310 and 2110 and IM-2310-2.¹⁷

B. Wilson’s Unauthorized Trading

The Hearing Panel found that Wilson engaged in unauthorized trading by effecting numerous mutual fund switches in the accounts of NA, DL, and EW without the customers’ permission, in violation of NASD Rule 2110 and IM-2310-2. We affirm this finding.

NASD Rule 2110 requires that persons associated with member firms “observe high standards of commercial honor and just and equitable principles of trade.” NASD IM-2310-2(b)(4)(iii) defines unauthorized trading as “[c]ausing the execution of transactions which are unauthorized by customers.” Wilson, as an associated person, was “responsible for obtaining his

¹⁶ As we discuss in Part III.B *infra*, customers DL and EW did not agree to any of the switches in their accounts and customer NA agreed to only one of the ten switches that Wilson effected in his account.

¹⁷ A violation of FINRA’s suitability rule is also a violation of NASD Rule 2110. *See Belden*, 56 S.E.C. at 505.

customer's consent prior to purchasing a security for the customer's account." *Carlton Wade Fleming, Jr.*, 52 S.E.C. 409, 412 (1995). "Unauthorized trades are a serious breach of the duty to observe high standards of commercial honor and just and equitable principles of trade." *Wanda P. Sears*, Exchange Act Rel. No. 58075, 2008 SEC LEXIS 1521, at *6 (July 1, 2008) (internal quotation omitted).

We have held that a customer's testimony alone, if credible, is sufficient to establish unauthorized trading. *Dist. Bus. Conduct Comm. v. Hellen*, Complaint No. C3A970031, 1999 NASD Discip. LEXIS 22, at *12 (NASD NAC June 15, 1999); *see also Robert E. Gibbs*, 51 S.E.C. 482, 483-84 (1993) (finding unauthorized transaction where no basis existed for disagreeing with credibility of customer's testimony that trade was unauthorized where such testimony "was comprehensive and was not discredited or called into question as the result of extensive cross-examination during the hearing" and "was consistent on the relevant facts with an affidavit that [customer] and his wife had previously submitted to the NASD"), *aff'd*, 25 F.3d 1056 (10th Cir. 1994). Both DL and EW testified that neither authorized the switches in their accounts and learned of them only upon receiving confirmations and account statements after the trades occurred. NA testified that Wilson spoke with him about switching one Class B-share position, but Wilson, without NA's permission, proceeded to switch NA out of all of his B-share positions. The Hearing Panel found DL's, EW's, and NA's testimony was credible.

Wilson argues that the customers' testimony is unreliable. Wilson contends that the customers' memories of their meetings and conversations with Wilson were limited. He further contends that DL's credibility was diminished when she acknowledged receiving monthly statements and confirmations that reflected the switches but did not complain about the trades at the time. We disagree with Wilson and find that the customers' testimony was reliable. The customers testified consistently and similarly that they did not authorize Wilson to make these switches.¹⁸ *See, e.g., Katz*, 2010 SEC LEXIS 994, at *74 & n.49 (finding that similarities in customer testimony is compelling and persuasive evidence of unauthorized trading). Further, we find that the evidence shows that Wilson exhibited a pattern of trading without customers' prior authorization. As we discuss with respect to Wilson's unauthorized discretionary trading in Part

¹⁸ Moreover the fact that DL did not complain at the time she learned of the switches does not shield Wilson from liability or serve to impugn DL's credibility. *See Janet Gurley Katz*, Exchange Act Rel. No. 61449, 2010 SEC LEXIS 994, at *74 & n.50 (Feb. 1, 2010) ("[W]hile the confirmations may have provided post-trade approval, ratification of a transaction after the fact does not establish that trades were authorized before being executed."), *aff'd*, 647 F.3d 1156 (D.C. Cir. 2011); *Neil C. Sullivan*, 51 S.E.C. 974, 976 & n.1 (1994) (finding that applicant had engaged in unauthorized trading and noting that "[t]he fact that a customer ultimately accepts an unauthorized trade does not transform it into an authorized purchase"); *cf. Wilshire Disc. Sec., Inc.*, 51 S.E.C. 547, 552 n.15 (1993) ("[E]ven assuming that certain investors ratified or endorsed [respondent's] action, that would not alter the objective fact that [respondent] fraudulently departed from the . . . stated use of proceeds.").

III.C, Wilson testified that he would determine which mutual funds the customers should liquidate to fund their monthly distributions and would notify the customers *after* the transactions occurred in some instances. We determine that Wilson has not set forth the substantial evidence necessary to overturn the Hearing Panel's credibility findings with respect to these customers. *See Dep't of Enforcement v. Mizenko*, Complaint No. C8B030012, 2004 NASD Discip. LEXIS 20, at *16 n.11 (NASD NAC Dec. 21, 2004), *aff'd*, Exchange Act Rel. No. 52600, 2005 SEC LEXIS 2655 (Oct. 13, 2005).

Accordingly, we conclude that Wilson violated NASD Rule 2110 and IM-2310-2 by making unauthorized trades.

C. Wilson's Exercise of Discretion Without Written Authorization

The Hearing Panel also found that Wilson exercised discretion in customer accounts without the requisite written authorization, in violation of NASD Rules 2510 and 2110. NASD Rule 2510(b) prohibits a registered representative from exercising any discretionary power in a customer's account unless such customer has given prior written authorization and the representative's firm has accepted the account.

It is undisputed that during the relevant period, Wilson did not have any discretionary accounts and the Firm prohibited registered representatives from discretionary trading in retirement accounts. Wilson nonetheless, according to testimony given by eight of his customers, exercised discretionary trading authority in their accounts.¹⁹ These customers uniformly testified that Wilson decided which positions in their accounts to sell for purposes of funding their IRC § 72(t) distributions and, in fact, sold these positions without contacting them and obtaining their prior approvals. Wilson testified that his sales assistant would contact the customers either at the time of the transaction or a day or two later.²⁰ The Hearing Panel found the customers' testimony more credible than Wilson's, noting the consistency of the customers' versions of events and Wilson's "cavalier attitude" toward contacting them. *See Katz*, 2010 SEC LEXIS 994, at *74 & n.49. Indeed, Wilson admitted that, in some instances, he did not contact the customers until *after* the transactions occurred, and he provided no evidence to show that he had procured prior *written* authorization from the customers or the Firm to exercise discretion. Based on a lack of substantial evidence, we will not disturb the Hearing Panel's credibility finding. *See Cody*, 2011 SEC LEXIS 1862, at *45 n.35.

Compliance with the requirements of NASD Rule 2510(b) is an additional means of ensuring effective supervision of sales practices at securities firms—supervision that Wilson evaded by failing to obtain written permission from his Firm and customers prior to effecting trades in these customers' accounts. *See Protective Group Sec. Corp.*, 51 S.E.C. 1233, 1240

¹⁹ The eight customers are Mr. JT, DL, EW, CG, RJ, EP, NA, and MR.

²⁰ Wilson's sales assistant did not testify at the hearing.

(1994). Thus, we affirm the finding that Wilson violated NASD Rules 2510(b) and 2110, as charged in the complaint.²¹ *Cf. Protective Group Sec. Corp.*, 51 S.E.C. at 1240 (finding liability for discretionary trading without written authorization after representative admitted making discretionary trades in customer accounts and had obtained oral authorization prior to the trades as well as written ratification subsequent to the trades).

D. Inaccurate Books and Records

NASD Rule 3110 requires member firms to “make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by SEC Rule 17a-3.” Under Exchange Act Rule 17a-3, a member firm must mark order tickets with the “terms and conditions of the order or instructions,” including whether the order was solicited or unsolicited. *See* 17 C.F.R. § 240.17a-3(a)(6)(i). Causing a member firm to enter false information in its books or records violates NASD Rule 3110 and also violates NASD Rule 2110’s requirement that members observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business. *See, e.g., Fox & Co. Inv., Inc.*, Exchange Act Rel. No. 52697, 2005 SEC LEXIS 2822, at *30-32 (Oct. 28, 2005) (finding that entering incorrect information in documents constitutes a violation of NASD Rules 3110 and 2110). The Hearing Panel found that Wilson violated these rules by causing Wachovia to make inaccurate entries in the mutual fund switch log that it required branch offices to maintain and by falsely representing that certain mutual fund transactions were unsolicited. We affirm these findings.

1. *Inaccurate Switch Log*

During the time when Wachovia employed Wilson, the Firm’s procedures required its branch managers to maintain logs of mutual fund switches and to send letters to customers for whose accounts switches were executed. The switch log recorded the specifics of the purchases and sales, the date the switch letters were sent to the customers, and the reason for the switches as given by the registered representatives who executed the transactions. The Firm designed the switch log as a supervisory tool to engage its branch management staff to ensure that customers were notified of any possible expenses or other shortcomings that might accompany a switch transaction. The switch letter described the switch transaction, including identifying the mutual funds traded and the switch transaction dates. At the hearing, Wilson acknowledged that he was aware of the Firm’s requirement regarding the switch log and switch letters and that, in part, the information that he or his sales assistant provided was used to create those records.

²¹ *See Guang Lu*, Exchange Act Rel. No. 51047, 2005 SEC LEXIS 117, at *19 n.22 (Jan. 14, 2005) (finding that, by violating NASD Rule 2510(b), respondent also violated NASD Rule 2110).

Wilson provided the Firm with false reasons for the switches that he executed for six customers in March 2001, which the Firm relied upon in preparing the switch log. He reported that switches in GB's account were executed "to allow client annual asset allocation out of C shares" and "to allow client annual asset allocation out of C shares without incurring fees." Wilson also gave the latter explanation for switches done in CG's account. Wilson's reported explanation for switches that he executed in DL's, EP's, MR's, and Mr. JT's accounts was "to allow annual asset allocation without incurring fees." Contrary to Wilson's reported reasons for these switches, the switches were done in an effort to stem market losses—not for the purpose of annual asset allocation—and each switch was *from* Class B shares *into* Class C shares, which caused the customers to incur CDSCs.

Wilson argues that because the Firm's branch operations manager maintained the switch log and prepared the switch letters, Wilson is not responsible for the Firm's inaccurate books and records. Wilson misses the point. Wilson was responsible for providing false reasons for the switches in the switch log, which the Firm relied upon and made part of its books and records. *See, e.g., Dep't of Enforcement v. Correro*, Complaint No. E102004083702, 2008 FINRA Discip. LEXIS 29, at *11-16 (FINRA NAC Aug. 12, 2008) (finding that representative caused his firm's inaccurate books and records when he falsely claimed that his customers were disabled on mutual fund sales orders in an effort to waive CDSCs). Moreover, Wilson's obfuscation served to undermine the Firm's supervision of him with respect to these transactions.

2. *Inaccurate Customer Confirmations*

In 2001 and 2002, Wachovia required its representatives to complete an order ticket whenever executing an order. On the order tickets, the Firm required that the representative report whether a trade was solicited or unsolicited. Wilson received copies of order tickets and accompanying trade confirmations, which the Firm required him to review for errors. If Wilson discovered an error, he was to report it to the Firm for correction.

Wilson testified that he generally never reviewed customer order tickets or confirmations for accuracy, but that he tasked his sales assistant, who completed the order tickets with direction from him, with this responsibility. Wilson acknowledged that he was ultimately responsible for the accuracy of the order information entered because he was the representative on the account.

We find that in March 2001 and August 2002, Wilson caused 31 mutual fund transactions that he solicited for three customers to be documented as unsolicited on the customer confirmations.²² RJ testified that the purchases for his account that were shown as unsolicited were Wilson's idea. According to RJ, "[Wilson] said that I need to get back in the market because I'm drawing money out every month and my account's going down and it was a good

²² Wilson caused nine mismarked purchases in RJ's account, six mismarked sales and eight mismarked purchases in EP's account, and eight mismarked sales in Mr. JT's account.

time to get back into the market.” When relating his conversation with Wilson regarding sales in his account, Mr. JT testified that Wilson “wanted to sell the B shares because they weren’t performing and wanted to get into something else.” Regarding the purchases of Class C shares for EP’s account, EP testified that “Wilson contacted me, and he said that if I don’t get into the mutual funds, I wouldn’t be able to recoup any of the losses if the market came back It wasn’t my idea . . . [i]t was his choice on where to put it.”

* * * * *

By providing the Firm with false information for the switches and by causing solicited transactions to be reflected as unsolicited on customer confirmations, Wilson violated NASD Rules 3110 and 2110.

E. Alleged Fraudulent Misrepresentations and Omissions

The Hearing Panel also found that Wilson made fraudulent misrepresentations and omissions to customers, in violation of Exchange Act Section 10(b) and Rule 10b-5 thereunder and NASD Rules 2120 and 2110. The Hearing Panel found that Wilson committed fraud when he told customers when pitching an initial investment with him that they could live off market gains, interest, and dividends without experiencing a reduction in principal; would receive high investment returns; and could live as well in retirement as they could if they were still working; and failed to disclose that customers could avoid CDSCs if they switched mutual funds within the same fund family.

We do not believe that Enforcement has met its burden in proving the alleged fraud. To establish that Wilson violated the antifraud provisions of the federal securities laws and NASD rules as charged, Enforcement must prove by a preponderance of the evidence that he either made material misrepresentations, or omitted material information, in connection with the purchase or sale of securities.²³ *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996); *Dep’t of Enforcement v. Gonchar*, Complaint No. CAF040058, 2008 FINRA Discip. LEXIS 31, at *27-28 (FINRA NAC Aug. 26, 2008), *aff’d*, Exchange Act Rel. No. 60506, 2009 SEC LEXIS 2797 (Aug. 14, 2009), *aff’d*, 409 F. App’x 396 (2d Cir. 2010). Enforcement also

²³ Exchange Act Section 10(b) makes it unlawful for any person “[t]o use or employ, in connection with the purchase or sale of any security . . . , any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe.” 15 U.S.C. § 78j(b). Exchange Act Rule 10b-5 makes it unlawful, in connection with the purchase or sale of any security, “[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading.” 17 C.F.R. § 240.10b-5(b). NASD Rule 2120 is FINRA’s antifraud rule and is similar to Exchange Act Section 10(b) and Rule 10b-5. *Mkt. Regulation Comm. v. Shaughnessy*, Complaint No. CMS950087, 1997 NASD Discip. LEXIS 46, at *24 (NASD NBCC June 5, 1997), *aff’d*, 53 S.E.C. 692 (1998).

must prove that he acted with scienter. *First Jersey Sec.*, 101 F.3d at 1467; *Dep't of Enforcement v. Apgar*, Complaint No. C9B020046, 2004 NASD Discip. LEXIS 9, at *11-12 (NASD NAC May 18, 2004). Scienter requires proof that a respondent intended to deceive, manipulate, or defraud, or that he acted with recklessness involving an extreme departure from the standards of ordinary care. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976); *Irfan Mohammed Amanat*, Exchange Act Rel. No. 54708, 2007 SEC LEXIS 2558, at *35 (Nov. 3, 2007), *aff'd*, 269 F. App'x 217 (3d Cir. 2008).

In finding that Wilson acted with scienter with respect to the alleged misrepresentations, the Hearing Panel found that Wilson “knew that he was making predictions that were intended to induce his clients to invest with him” and that “he must have known” that the predicted retirement incomes “were not realistic.” We disagree and find that the evidence does not show that Wilson engaged in an extreme departure from the standards of ordinary care. For example, when making his initial investment recommendations, Wilson reviewed the customers’ financial situation, including whether they intended to continue working, other sources of income, their income requirements in retirement, and the total amount of their lump sum investments. And in making his presentations to the customers, he provided them with the actual performance over the five prior years of each of the mutual funds that he recommended.²⁴ Based on his review of the customers’ financial situation combined with the performance of the recommended mutual funds, we conclude that Wilson’s recommendations were overly optimistic. We do not find, however, that he intended to deceive or that his actions were an extreme departure from the standards of ordinary care for a registered person.

The Hearing Panel made no scienter finding with respect to the omissions, despite determining that Wilson violated the federal antifraud provisions and related NASD antifraud rules. While it is clear that Wilson did not make a proper suitability determination that took into consideration the cost of the switches and effect on the anticipated return on investment, he made the switches to funds in other fund families in an effort to bolster his customers’ investment returns. The record in this case demonstrates that Wilson acted in a misguided effort to stem his customers’ losses by effecting the switches. The evidence does not show, however, that Wilson intentionally or recklessly withheld information from his customers.

Because we find that Enforcement has not proven that Wilson acted with the requisite scienter, we dismiss the Hearing Panel’s finding that Wilson engaged in fraud, in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rules 2120 and 2110.²⁵

²⁴ The past performance of a mutual fund, however, does not guarantee future results. *See, e.g.*, Securities Act of 1933 Rule 482(b)(3)(i).

²⁵ We therefore do not reach the issue of whether the alleged misstatements and omissions were material.

IV. Procedural Issues

Wilson challenges the fairness of the proceedings below. Wilson alleges that the Hearing Officer was biased against him, which resulted in a denial of his due process. Wilson points to the Hearing Officer's "repeated refusal to grant [his attorney's] multiple objections" to Enforcement's "leading questions of all of the customer witnesses" as evidence of bias. A Hearing Officer is expressly charged with "regulating the course of the hearing." FINRA Rule 9235(a)(2). "Adverse rulings, by themselves, generally do not establish improper bias." *Epstein*, 2009 SEC LEXIS 217, at *62; *cf. Liteky v. United States*, 510 U.S. 540, 555 (1994) (stating that "judicial rulings alone almost never constitute a valid basis for a bias or partiality motion"); *United States v. Azhocar*, 581 F.2d 735, 739 (9th Cir. 1978) (determining that, in a criminal case, a trial judge's "[a]dverse rulings do not constitute the requisite bias or prejudice" warranting re-assignment of the proceeding to another trial judge). The Commission has stated that "bias by a hearing officer is disqualifying only when it stems from an extrajudicial source and results in a decision on the merits based on matters other than those gleaned from participation in a case." *Epstein*, 2009 SEC LEXIS 217, at *62 (internal quotations omitted). We find that the record evidence before us does not demonstrate bias on the part of the Hearing Officer. *See, e.g., Robert Fitzpatrick*, 55 S.E.C. 419, 431-32 (2001) (finding no evidence of Hearing Panel bias and holding that there is no evidence that the Hearing Panel member formed an opinion in the case based on anything other than the evidence before it).

Wilson also argues that the customers' testimony was "coached" by Enforcement and therefore unreliable. Wilson confuses Enforcement's preparation of its customer witnesses with coaching. Conferring with witnesses is a necessary and appropriate component of trial preparation. *See Dist. Bus. Conduct Comm. v. O'Brien*, Complaint No. C10920025, 1993 NASD Discip. LEXIS 247, at *40 (NASD NBCC Aug. 20, 1993) (finding that NASD regional attorney rendered no inappropriate assistance to customer witness as a result of preparation of the witness's testimony before the hearing). The customers were direct and forthright, candidly acknowledging that they met with Enforcement staff in advance of the hearing and reviewed documents to aid in their recall of events that occurred years earlier. In responding to questions during the hearing, the customers also acknowledged if they did not remember something. Nothing in their words suggested coaching. Furthermore, Wilson had ample opportunity to extensively cross-examine each of the customers as the hearing transcript illustrates. And as we noted, Wilson has not demonstrated the existence of substantial evidence sufficient to overturn the Hearing Panel's determinations that the customer witnesses' testimony was credible. *See Mizenko*, 2004 NASD Discip. LEXIS 20, at *16 n.11.

The record demonstrates that, both before the Hearing Panel and on appeal, Wilson has been given multiple opportunities to present his case. The Hearing Panel provided Wilson with the opportunity to testify, adduce evidence, and cross-examine witnesses. *See, e.g., E. Magnus Oppenheim & Co.*, Exchange Act Rel. No. 51479, 2005 SEC LEXIS 764, at *10 (Apr. 6, 2005) (rejecting claim that NASD denied respondent due process where "NASD conducted a hearing on the record at which Applicant was given the opportunity to confront and cross-examine adverse witnesses and to present Applicant's own case and witnesses"). In addition, our de novo

review of the record assures that Wilson is given a fair proceeding.²⁶ *Dep't of Enforcement v. Bullock*, Complaint No. 2005003437102, 2011 FINRA Discip. LEXIS 14, at *52-53 (FINRA NAC May 6, 2011); *see also Dep't of Enforcement v. Dunbar*, Complaint No. C07050050, 2008 FINRA Discip. LEXIS 18, at *33 (FINRA NAC May 20, 2008) (holding that the NAC's de novo review cures alleged Hearing Panel prejudice).

V. Sanctions

The Hearing Panel barred Wilson for recommending unsuitable switches and engaging in unauthorized trading. We affirm both bars. We decline to impose sanctions for Wilson's exercise of discretion without written authority and causing inaccurate books and records, in light of the two bars.²⁷

A. Suitability and Unauthorized Trading

1. *Suitability*

The FINRA Sanction Guidelines ("Guidelines") for unsuitable recommendations suggest a fine of \$2,500 to \$75,000.²⁸ In addition, the Guidelines suggest a suspension of 10 business days to one year, and in egregious cases, adjudicators should consider a suspension of up to two years or a bar.²⁹ Turning to the Principal Considerations applicable to all violations, we find that several factors serve to aggravate Wilson's misconduct and elevate this case to an egregious one. Wilson's unsuitable transactions were in serious breach of his duty to his customers. Wilson engaged in a course of mutual fund switching in his customers' accounts that was without concern for the customers' understanding of the costs or their willingness to accept those costs.

²⁶ To the extent that Wilson is asserting a constitutional challenge, multiple federal courts have held that constitutional protections are inapplicable to FINRA proceedings. *See, e.g., Lugar v. Edmondson Oil Co.*, 457 U.S. 922, 936-37 (1982) (noting that the Fifth and Fourteenth Amendments to the United States Constitution protect individuals only against violation of constitutional rights by the government, not private actors); *Desiderio v. NASD*, 191 F.3d 198, 206 (2d Cir. 1999) (finding that NASD is not a state actor, and constitutional requirements generally do not apply to it).

²⁷ The Hearing Panel imposed a third bar for the fraudulent misrepresentations and omissions. Because we dismiss the findings of violation, we also eliminate the bar imposed below for this cause of action.

²⁸ *FINRA Sanction Guidelines* 94 (2011), <http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf> [hereinafter *Guidelines*].

²⁹ *Id.*

Wilson's trading involved numerous switching transactions, which caused the customers to incur substantial CDSCs and disrupted their original investment's holding period and the availability of lower expenses.³⁰ Wilson did not ensure that the customers, who were unsophisticated investors, understood the consequences of these switches.³¹ And with respect to several customers, Wilson's trading was done without their consent. Wilson also earned more than \$36,000 in commissions from the new mutual fund purchases.³²

Throughout these proceedings, Wilson repeatedly emphasized that he intended no harm and was acting only to help his customers mitigate their losses arising from the slumping market conditions. Contrary to Wilson's argument in favor of mitigation that he acted only in an effort to help his customers during a unique period of market decline, we find that he acted with a reckless disregard for his customers' financial well-being by recommending the switches.³³ Moreover, we are deeply troubled by Wilson's obfuscation with respect to the switches made for several customers. The false reasons for the switches that Wilson provided to his Firm and the inaccurate designations of certain switch transactions on customer confirmations served to conceal the true nature of these transactions from his Firm.³⁴

Wilson also has not accepted responsibility for his misconduct and blames everyone but himself for his predicament.³⁵ He blames his customers for not staying the investment course that he initially charted for them, he blames the market and the fund managers for the funds' decline, and he blames his sales assistant for myriad failures, including actually making the trades that he recommended. Wilson's own misunderstanding of *his* unequivocal suitability obligations warrants significant sanctions. *See, e.g., Mayer A. Amsel*, 52 S.E.C. 761, 768 (1996) (affirming bar where applicant "exhibited a disturbing disregard for the standards that govern the securities industry"); *Michael G. Keselica*, 52 S.E.C. 33, 37 (1994) (determining "attempts to blame others for his misconduct . . . demonstrate that [the respondent] fails to understand the seriousness of [his] violations"), *petition for review dismissed*, No. 95-1012, 1995 U.S. App. LEXIS 40288 (D.C. Cir. 1995). While we acknowledge that Wilson has since changed his practice model and now recommends Class A shares for new customers, his new course is insufficient to overcome the sharp deviations from the standards imposed upon registered

³⁰ *Id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8, 11, 18).

³¹ *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 19).

³² *Id.* (Principal Considerations in Determining Sanctions, No. 17).

³³ *Id.* (Principal Considerations in Determining Sanctions, No. 13).

³⁴ *Id.* at 6 (Principal Considerations in Determining Sanctions, No. 10.)

³⁵ *Id.* (Principal Considerations in Determining Sanctions, No. 2).

representatives that his misconduct reflects. We find that a bar is appropriately remedial for Wilson's unsuitable switches.

2. *Unauthorized Trading*

For violations of NASD Rule 2110 and IM-2310-2 based on unauthorized transactions, the Guidelines recommend a fine of \$5,000 to \$75,000.³⁶ The Guidelines also recommend a suspension in any and all capacities for a period of 10 business days to one year.³⁷ In egregious cases, the Guidelines recommend a longer suspension of up to two years or a bar.³⁸ The Guidelines set forth two specific considerations to determine sanctions in unauthorized transaction cases: whether the respondent misunderstood his or her authority or the terms of the customers' orders, and whether the unauthorized trading was egregious.³⁹ With the exception of one of the switches effected in NA's account, Wilson had no authority from three customers to make the switch transactions. As a result, Wilson's unauthorized trading enabled him to execute unsuitable mutual fund switches. In addition, Wilson profited from his misconduct in the form of commissions for these transactions.⁴⁰ These facts serve to aggravate Wilson's misconduct.

The Hearing Panel found Wilson's unauthorized trading was egregious and barred him for it. We agree with this determination. To determine whether the unauthorized trading is egregious, the NAC has identified three categories of egregious trading: (1) quantitatively egregious unauthorized trading; (2) unauthorized trading accompanied by aggravating factors, such as efforts to conceal the unauthorized trading, attempts to evade regulatory investigative efforts, customer loss, or a history of similar misconduct; and (3) qualitatively egregious unauthorized trading, which is measured by the strength of the evidence and the respondent's motives in effecting the trades. *See Hellen*, 1999 NASD Discip. LEXIS 22, at *15-24. We find that several additional aggravating factors accompany Wilson's unauthorized trading. Wilson transacted more than 80 switches without consent.⁴¹ In addition, the customers incurred fees from the unauthorized trades.⁴² Wilson also attempted to conceal the unauthorized trades done

³⁶ *Guidelines*, at 98.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 17).

⁴¹ *See Guidelines*, at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8, 18).

⁴² *See id.* (Principal Considerations in Determining Sanctions, No. 11).

in customer DL's account.⁴³ As previously discussed, Wilson reported to his Firm that he executed switches in DL's account "to allow annual asset allocation without incurring fees" when in fact the switches were done to stem market losses and caused DL to incur CDSCs.

We conclude that Wilson's unauthorized trading warrants a bar. Wilson's unauthorized trading goes "to the heart of the trustworthiness of a securities professional" and "is a fundamental betrayal of the duty owed . . . to his customers." *See Adam Stuart Levine*, 51 S.E.C. 395, 397 (1993); *Keith L. DeSanto*, 52 S.E.C. 316, 323 (1995), *aff'd*, 101 F.3d 108 (2d Cir. 1996). The imposition of a bar is necessary here to protect the investing public. *See, e.g., Cathy Jean Krause Kirkpatrick*, 53 S.E.C. 918, 931-32 (1998) (affirming a bar where applicant engaged in unauthorized trades).

B. Exercise of Discretion Without Written Authority and Books and Records Violations

The Guidelines for exercising discretion without written authority in violation of NASD Rules 2510 and 2110 recommends a fine of \$2,500 to \$10,000.⁴⁴ In an egregious case, the Guidelines recommend a suspension in any or all capacities for 10 to 30 business days.⁴⁵ The Guidelines list two factors to consider in determining the proper remedial sanction: whether the customer's authorization of discretion was express or implied, and whether the firm's policies prohibited discretionary trading. In this case, we find both factors applicable and aggravating. None of the eight customers gave Wilson authority to choose which mutual funds to sell to make their monthly distributions. Wilson's Firm also had a policy prohibiting representatives from exercising discretionary authority over any customer retirement accounts.

For recordkeeping violations, the Guidelines recommend imposing a fine of \$1,000 to \$10,000, suspending the firm for up to 30 business days, and suspending the responsible individual for up to 30 business days.⁴⁶ The Guidelines instruct adjudicators to consider the nature and materiality of inaccurate or missing information.⁴⁷ The false reasons that Wilson provided for the mutual fund switches and the inaccurate characterization of customer orders as unsolicited are important components of customer records in the securities industry. *See Edward J. Mawod & Co.*, 46 S.E.C. 865, 873 n.39 (1977), *aff'd*, 591 F.2d 588 (10th Cir. 1979); *see also*

⁴³ *See id.* at 6 (Principal Considerations in Determining Sanctions, No. 10).

⁴⁴ *Guidelines*, at 85.

⁴⁵ *Id.*

⁴⁶ *Id.* at 29. In egregious cases, the Guidelines recommend imposing a fine of \$10,000 to \$100,000, and a lengthier suspension (up to two years) or barring the responsible individual. *Id.*

⁴⁷ *Id.*

James F. Novak, 47 S.E.C. 892, 898-99 (1983) (describing falsification of order tickets as serious misconduct). This misinformation deprived the Firm of the opportunity to more closely scrutinize the mutual fund transactions. Thus, had Wilson correctly designated reasons for the switches and the applicable trades as solicited, the Firm would have been on notice to evaluate the suitability of the transactions more carefully. Recordkeeping rules are the “keystone of the surveillance of brokers and dealers,” and Wilson’s misinformation undermined the accuracy of the Firm’s records. *See Mawod*, 46 S.E.C. at 873 n.39.

Because we order Wilson barred for other misconduct, we decline to impose sanctions for his exercise of discretion without written authority and the books and records violations.

* * * * *

Wilson’s behavior, particularly his disregard for the financial well-being of his customers and his failure to take responsibility for his misconduct, provides no assurance that he will not repeat his violations. Here, Wilson not only made unsuitable switch recommendations and engaged in unauthorized trades, but he also exercised unauthorized discretion in customer accounts and attempted to conceal his misconduct by causing Wachovia’s books and records to reflect inaccurate information. These violations represent a pattern of disregard for the high standards to which registered representatives must adhere. Barring Wilson will therefore prevent him from putting additional customers at risk and will serve as a deterrent against others in the securities industry from engaging in similar misconduct.

VI. Conclusion

We affirm the Hearing Panel’s findings that Wilson made unsuitable recommendations, in violation of NASD Rules 2310 and 2110 and IM-2310-2; engaged in unauthorized trading, in violation of NASD Rule 2110 and IM-2310-2; exercised discretion without written authority, in violation of NASD Rules 2510(b) and 2110; and caused his Firm’s inaccurate books and records, in violation of NASD Rules 3110 and 2110. Accordingly, we bar Wilson for making unsuitable recommendations and impose a separate bar for his unauthorized trading. The bars are effective upon service of this decision. We also order Wilson to pay hearing costs of \$13,465.80.⁴⁸

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith
Senior Vice President and Corporate Secretary

⁴⁸ We also have considered and reject without discussion all other arguments of the parties.