N E W Y O R K S T O C K E X C H A N G E, I N C.

EXCHANGE HEARING PANEL DECISION 02-185 **September 24, 2002**
ARTHUR DONALD ELROD
REGISTERED REPRESENTATIVE

* * *

Effected unsuitable transactions in customer accounts – Consent to censure, three month suspension, $5,000 fine, and a requirement for enhanced supervision for one year.

EXCHANGE HEARING PANEL DECISION 02-186
RANDALL CRAIG PECK
BRANCH OFFICE MANAGER

* * *

Violated Exchange Rule 342 by failing to reasonably discharge his duties and obligations in connection with supervision and control, and violated Exchange Rule 405(2) in that he failed to supervise diligently one or more accounts – Consent to censure, one month supervisory suspension, a fine of $3,000 and a requirement that he complete a training course.

Appearances:

For the Division of Enforcement
James D. O'Donnell, Esq.
Audra A. Acquavella, Esq.

For the Respondents
Jeff Jamieson, Esq.

* * *

An Exchange Hearing Panel met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange's Division of Enforcement and Arthur Donald Elrod, a registered representative, and Randall Craig Peck, a branch office manager, both with A.G. Edwards & Sons, Inc. (the "Firm"). Without admitting or denying guilt, both consented to findings by the Hearing Panel.

Mr. Elrod consents to a finding by the Hearing Panel that he engaged in conduct inconsistent with just and equitable principles of trade in that he effected transactions in customer accounts of his member organization employer that were unsuitable in view of the customers' age, investment experience, investment objectives and financial resources.

Mr. Peck consents to findings that he:

I. Violated Exchange Rule 342 by failing to reasonably discharge his duties and obligations in connection with the supervision and control of the activities of a registered representative of his member organization employer.

II. Violated Exchange Rule 405(2) in that, in his capacity as a branch office manager, he failed to supervise diligently one or more accounts handled by a registered representative of his member organization employer.

For the sole purpose of settling this disciplinary proceeding, the Division of Enforcement, Mr. Elrod and Mr. Peck stipulate to certain facts, the substance of which follows:

Background and Jurisdiction

1. Elrod was born in [redacted]. He entered the securities industry in 1977 as a stock trainee with Firm A. In 1978, Elrod joined the Firm, a member organization, as a stock trainee and was approved by the Exchange as a registered representative in May 1978. From May 1978 to present and at all relevant times, Elrod has been employed by the Firm as a registered representative in the Firm's branch office in Omaha, Nebraska (the "Branch").

2. Peck was born in August 1953. He entered the securities industry in July 1976 when he commenced employment with Firm B. and was approved by the Exchange as a registered representative in October 1976. Peck remained at Firm B until June 1980 and was thereafter employed in the securities industry as follows:

Dates	Firm
6/80 – 9/83	Firm C
9/83 – 12/86	Firm D
1/87 – 12/90	Firm E

In December 1990, Peck became employed by the Firm as a registered representative, where he is currently employed. In or about July 1991, Peck became Series 8 registered and, shortly thereafter, was made an assistant branch office manager of the Branch. In or about 1994, Peck was made branch office manager of the Branch.

3. In or about April 1999, the Exchange's Division of Member Firm Regulation ("MFR") conducted a supervisory standards/sales practice examination of the Firm and issued a report of the exceptions noted by MFR including certain exceptions involving the activities of Elrod and Peck. In or about September 1999, MFR referred to Enforcement its examination report of the Firm. Thereafter, Enforcement conducted an investigation into, among other things, the activities of Elrod and Peck as noted in the 1999 examination report.

4. During Enforcement's investigation, Elrod and Peck, represented by counsel, appeared and testified in connection with the investigation.

Summary of Violative Conduct

5. During the period of August 1996 through May 1997, on various occasions, Elrod solicited and recommended the purchase of a speculative, high-yield bond which was unsuitable in various customer accounts in view of the age, investment experience, investment objectives, and financial resources of such customers. Peck, in his capacity as branch office manager, failed to supervise certain customer accounts handled by Elrod, as set forth below.

Elrod's Unsuitable Recommendation

6. During the ten-month period of August 1996 through May 1997 (the "Relevant Period"), Elrod solicited and recommended the purchase of XYZ 9.125% 4-15-03 Senior Subordinate Notes (the " XYZ Bonds"), a speculative, high-yield bond, rated below investment grade, in the accounts of approximately 147 customers at an aggregate total cost of approximately $4.2 million. Elrod acknowledges that the recommendation to purchase XYZ Bonds was the single largest broad-based recommendation he made during his tenure at the Firm.

7. The XYZ Bonds were not followed by the Firm's research department. Elrod maintained a research file on XYZ Bonds.

8. The XYZ Bonds were issued in April 1993 by XYZ, a retailer of lumber, building materials and home improvement products. The XYZ Bonds traded on the Exchange until July 1997. Interest on the XYZ Bonds was payable on April 15 and October 15 of each calendar year.

9. Most of the approximately 147 customers who purchased XYZ Bonds on Elrod's recommendation were elderly, with limited financial resources, were not sophisticated investors and relied on Elrod. Many of the approximately 147 customers solicited to purchase XYZ Bonds had primary investment objectives of "safety of principal", "growth" or "income."

10. Upon Elrod's recommendation, 19 of the customer accounts invested the account's total equity in XYZ Bonds, and 49 of the customer accounts had concentrated positions of 50% or greater of the account's total equity in XYZ Bonds.

11. During the period of Elrod's solicitation of the XYZ Bonds, the value of the bonds fell precipitously in November 1996 and December 1996, following two bond rating agency downgrades. Despite the downgrades and the steep decline in price, Elrod continued to recommend the purchase of XYZ Bonds and/or advised customers to continue to hold existing positions and not sell the XYZ Bonds.

12. In May 1997, the Branch requested a research opinion from the Firm's fixed income research department. In a report dated May 15, 1997, the Firm described the XYZ Bonds as "highly speculative" with expectations that the price of the bonds would continue to deteriorate.

13. Thereafter, on or about July 8, 1997, a condensed version of Firm's research report was sent to Elrod's customers. On or about July 21, 1997, XYZ filed for bankruptcy protection and thereafter in October 1997 defaulted on its interest payments.

14. The XYZ Bonds were not priced on most customer monthly account statements until July 1997. By July 1997, the price of the XYZ Bonds had fallen from an average purchase price of $65 to approximately $15 par value per bond.

15. At all times relevant herein, price quotations for the XYZ Bonds were published and available in the Wall Street Journal and other publications.

16. Elrod's recommendation of XYZ Bonds was unsuitable for various customer accounts, including those described below, in view of the customer's investment experience, investment objectives, financial resources and the concentration levels of the XYZ Bonds in the customer's account.

17. Elrod's unsuitable recommendation harmed customers, including but not limited to the following customers described below as examples, who suffered financial loss.

Examples of Customer Accounts

Account of LW

18. In November 1991, LW, a telemarketer born in 1927, opened an account with the Firm which was handled by Elrod (the "LW Account"). At or about the time the account was opened, LW advised Elrod that his primary source of income was from social security and that he could not afford to lose his investment or incur a great deal of risk in the account.

19. According to the new account documents completed for the LW Account, LW's investment objectives were reported, in order of priority, as "safety of principal," "income" and "growth." His investment experience is described as 50 years in CDs. According to LW, his net worth was approximately $70,000.

20. In October 1996, on Elrod's recommendation, LW invested approximately $35,000 in XYZ Bonds. The XYZ bond purchase represented 100% of the net equity in the LW Account.

21. LW's approximately $35,000 investment in the XYZ Bonds is currently worthless.

22. The LW Account was concentrated in a speculative corporate bond which was unsuitable in view of the customer's investment objectives, investment experience and financial resources.

Account of DR

23. In July 1982, DR, a retired clerk born in 1921, opened an account with the Firm which Elrod handled (the "DR Account"). According to the new account documents completed for the DR Account, DR's investment objectives are described, in order of priority, as "safety of principal," "income," and "growth" with a net worth of $75,000 and annual income of $26,000.

24. In August 1996, upon Elrod's recommendation, DR invested approximately $18,000 in XYZ Bonds. In January 1997, on Elrod's recommendation, DR increased her position in the XYZ Bonds, investing an additional approximately $28,000 in the account. The total XYZ purchases of $46,000 represented an aggregate total of approximately 72% of the net equity in the DR Account.

25. DR's approximately $46,000 investment in the XYZ Bonds is currently worthless.

26. The DR Account was concentrated in a speculative corporate bond which was unsuitable in view of the customer's investment objectives, investment experience and financial resources.

Account of FS

27. In June 1991, FS, a retired clerk born in 1929, opened an account with the Firm which was handled by Elrod (the "FS Account"). According to the new account documents completed for the FS Account, FS' annual income was approximately $19,000 and her net worth was $140,000. FS' investment objectives are recorded on the new account documents, in order of priority, as "growth" and "income." FS is described as having 15 years investment experience in stocks and bonds and 34 years investment experience in certificates of deposit ("CDs").

28. In August 1996, on Elrod's recommendation, FS invested approximately $20,000 in XYZ Bonds. In March 1997, on Elrod's recommendation, FS increased the size of her position in XYZ Bonds by investing an additional $12,000 in the bonds. The XYZ purchases represented approximately 70% of the net equity in the FS Account.

29. FS' approximately $32,000 investment in the XYZ Bonds is currently worthless.

30. The FS Account was concentrated in a speculative corporate bond which was unsuitable in view of the customer's investment objectives, investment experience and financial resources.

Account of JO

31. In or about July 1988, JO, a construction laborer born in 1942, opened an account with the Firm which was handled by Elrod (the "JO Account"). According to the new account documents completed for the JO Account, JO's primary and sole investment objective was "Growth," with a net worth of approximately $50,000 and annual income of $16,000. At the time the account was opened, JO had 6 years of investment experience in stocks and bonds.

32. On or about October 4, 1996, on Elrod's recommendation, JO invested approximately $41,400 in XYZ Bonds. With the exception of a small money market position, the XYZ purchase represented approximately 100% of the net equity in the JO Account.

33. JO's approximately $41,400 investment in the XYZ Bonds is currently worthless.

34. The JO Account was concentrated in a speculative corporate bond which was unsuitable in view of the customer's investment objectives, investment experience and financial resources.

Account of J and EA

35. In April 1986, J and EA, an office clerk and a homemaker born in 1936, opened an account with the Firm which Elrod handled (the "As Account").

36. According to the new account documents, J and EA had a combined net worth of approximately $150,000 with an annual income of $25,000 and 15 years investment experience in stocks and bonds. According to updated new account documents completed for the As Account in August 1995, the As' investment objectives are described, in order of priority, as "income" and "growth."

37. In January 1997, upon Elrod's recommendation, the As invested approximately $30,000 in XYZ Bonds. The XYZ purchase represented approximately 98% of the net equity in the As Account.

38. The As' approximately $30,000 investment in the XYZ Bonds is currently worthless.

39. The As' Account was concentrated in a speculative corporate bond which was unsuitable in view of the customers' investment objectives, investment experience and financial resources.

Failure to Supervise

40. During the Relevant Period, Peck was responsible for the supervision of Elrod and customer accounts handled by Elrod.

41. During the Relevant Period, the Firm had procedures in place requiring that Peck review customer account activity on a quarterly basis to identify, among other things, unusual trading activity, including concentration of purchases or sales in a particular security, suitability of investments, and significant losses. In addition, Peck, as branch office manager, was required to conduct a daily review of a trade run for the Branch which identified all trading in accounts, including bond transactions, for the prior day.

42. During the Relevant Period, Peck reviewed order tickets on a daily basis, reviewed new account forms and reviewed monthly and quarterly reports involving trading activity at the Branch.

43. During the Relevant Period, Peck did not conduct a review of XYZ bond positions in Elrod's customer accounts. Peck did not review Elrod's customer accounts to identify concentration levels or suitability of such purchases of XYZ Bonds. Further, Peck did not discuss with Elrod the XYZ bond positions in the context of the financial profiles and investment objectives of the customer accounts. Peck did not review Elrod's research file on XYZ Bonds.

44. The XYZ Bonds were downgraded in November and December 1996. It was not until May 1997 that Peck spoke with Elrod about his broad-based recommendation of the XYZ Bonds and requested a research opinion from the Firm's fixed income research department. In a May 15, 1997 report, the Firm described the XYZ Bonds as "highly speculative" with expectations that the price of the bonds would continue to deteriorate.

45. In early July 1997, a condensed report of the Firm's research opinion on XYZ Bonds was sent to Elrod's customers. On or about July 21, 1997, XYZ filed for bankruptcy protection and thereafter defaulted on its interest payments.

46. As a result of the information available to Peck regarding Elrod's recommendation of the XYZ Bonds, the size and the speculative nature of the bond positions recommended by Elrod, Peck had sufficient information as to the nature of the bond transactions effected in the customer accounts to require further inquiry because the recommendation of such large and concentrated positions in XYZ Bonds appeared inconsistent with the financial profile and investment objectives of numerous customer accounts.

47. Nevertheless, Peck did not contact the customers, either personally or by letter, to assess customer suitability in connection with the purchases of the XYZ Bonds.

48. During the Relevant Period, Peck did not supervise reasonably and diligently the customer accounts handled by Elrod with respect to the XYZ transactions.

49. Based upon the information available to Peck, further supervisory review was needed in order to detect and prevent violative activity in Elrod's customer accounts.

50. In summary, during the Relevant Period, Peck did not supervise reasonably and diligently certain customer accounts handled by Elrod in that (a) Peck did not question, discuss or make adequate inquiry of Elrod about the suitability of the XYZ bond purchases in the customer accounts; and/or (b) did not take any action to correct the unsuitable recommendation and purchase of XYZ Bonds in the customers' accounts; and/or (c) did not contact the customers to ascertain whether the XYZ bond purchase was suitable for the customers in view of each of their age, financial resources and investment objectives.

DECISION

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found Mr. Elrod and Mr. Peck guilty as set forth above by unanimous vote.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, imposed the penalty consented to by Mr. Elrod of a censure, a suspension for a period of three months from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization, a fine of $5,000, and a requirement to be subject to appropriate enhanced supervision, not unacceptable to the Exchange, by his member firm employer for a period of one year subsequent to the completion of the above mentioned suspension.

In view of the above findings, the Hearing Panel, also by unanimous vote, imposed the penalty consented to by Mr. Peck of a censure, a one month supervisory suspension, a fine of $3,000, and a requirement that he complete an appropriate training course, involving supervision of fixed income products, as a prerequisite to resuming employment in a supervisory capacity.

For the Hearing Panel

Vincent F. Murphy
Hearing Officer