

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 03-201

November 4, 2003

FERNANDO A. GALLARDO

FORMER REGISTERED REPRESENTATIVE

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Misappropriated customer funds; commingled customer funds; effected unauthorized transactions in a customer's account; violated Exchange Rule 346(b) by engaging in outside business activity without employer consent – Censure and permanent bar.

Appearances:

For the Division of Enforcement
Susan F. Axelrod, Esq.
Craig P. Hammond, Esq.
Felix M. Hester, Esq.
Bettina M. Sacklowski

For the Respondent
Jane Becker Whitaker, Esq.

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An Exchange Hearing Panel conducted a hearing on charges brought by the Exchange's Division of Enforcement against Fernando A. Gallardo, a former registered representative with Morgan Stanley Dean Witter Inc. (the "Firm"). Mr. Gallardo was charged with having:

- I. Engaged in conduct inconsistent with just and equitable principles of trade in that he misappropriated funds belonging to a customer of his member firm employer.
- II. Engaged in conduct inconsistent with just and equitable principles of trade in that he commingled funds belonging to a customer of his member firm employer.
- III. Engaged in conduct inconsistent with just and equitable principles of trade in that he effected unauthorized transactions in the account of a customer of his member firm employer.
- IV. Violated Exchange Rule 346(b) in that, without making a written request and receiving prior written consent of his member firm employer, he engaged in an outside business activity.

Mr. Gallardo, through his attorney, submitted an Answer to the Charge Memorandum which denied the charges. He denied commingling and misappropriating a customer's funds; rather, he asserted that his customer had endorsed a check to him, which he deposited in his account so that she could receive the funds in cash. Mr. Gallardo claimed that he immediately gave the cash to

his customer. Mr. Gallardo denied that he had effected unauthorized trades for the customer; rather, he claimed that the customer was aware of and authorized each transaction in her account. As to the charge that he had engaged in an outside business activity without employer consent, Mr. Gallardo claimed that the business venture never materialized and there was, therefore, nothing to disclose to his employer.

Mr. Gallardo claimed inability to appear at the hearing, but was represented by his attorney. After the presentation of the Division of Enforcement's case, Mr. Gallardo, through his attorney, waived his right to a continuation of his presentation of his defense before the Hearing Panel, acknowledging that, in doing so, he was fully aware of the possible consequences, including that he may be barred from the securities industry for life.

On the basis of the testimony and documentary evidence presented at the hearing, the Hearing Panel found as follows:

Background and Jurisdiction

1. Fernando A. Gallardo ("Gallardo") was born on June 13, 1974. He entered the securities industry in May 1999 when he began working for the Firm in its San Juan, Puerto Rico branch office ("San Juan Branch"). In July 1999, he became a registered representative ("RR") with the Firm. On March 30, 2001, Gallardo resigned from the Firm and was employed by a non-member firm until October 2003.
2. On or about May 14, 2001, the New York Stock Exchange, Inc. (the "Exchange") received a Uniform Termination Notice for Securities Industry Registration ("Form U-5") from the Firm reporting allegations that Gallardo had effected unsuitable and unauthorized transactions and misappropriated funds from a customer's account. The Firm further reported that Gallardo had been permitted to resign for violating the Firm's policies concerning outside business activities.
3. By letter dated May 17, 2001, which Gallardo received, the Division of Enforcement ("Enforcement") notified Gallardo of its inquiry into the matters noted in the Form U-5.

Unauthorized Trading and Misappropriation

4. In or about October 1999, a Customer (hereinafter the "Customer") opened an account at the Firm with her relative, Gallardo, who was a registered representative in the Firm's San Juan Branch Office.
5. The Customer, a resident of a South American country, opened the account while visiting relatives in Puerto Rico. The Customer was college-educated; she was employed as a paralegal. She had no knowledge, however, of financial markets. The Customer's intention, in opening the account, was to keep her funds safe. There was

- political turmoil in her country. Moreover, her father was ill with cancer, and she wanted to secure funds, in dollars, available, as necessary, to pay expenses incurred by her father's illness.
6. The Customer's New Account Form ("NAF") reflected that she had an income of \$23,000 and a net worth of \$200,000. Additionally, the NAF reflected that the account was a non-discretionary account.
 7. The Customer's NAF reflected that the Customer had no prior investment experience and her investment objectives in order of priority were capital appreciation, speculation, aggressive income and income. The Customer had indicated, however, that the account was to be an interest-paying checking account. She did not review the NAF when it was prepared, and did not receive a copy thereafter.
 8. The Customer opened the account with \$5,000 and added another \$12,000 in ensuing months.
 9. The Customer was concerned that copies of her account statements not be mailed to her home; the political situation in her country was such that the government might move against funds held outside the country. Consequently, she asked that the account's address be changed to go to a trusted relative in Puerto Rico. The statements were forwarded to that address commencing with the December 1999 statement, and the address change was formalized in February 2000.
 10. The account was initially invested in a dollar income fund. In December 1999, an investment in an internet trust fund was added, and the Customer sought an explanation as to whether the amount invested included her "earnings." At the same time, she enclosed a check for \$7,000 for additional deposit to her account.
 11. In the first months of the account, Gallardo would call the Customer every week or two. He would inform her that the account was doing well and then go on to discuss family matters. Such calls dropped off by February 2000. Specific transactions in the Customer's account were neither discussed nor authorized.
 12. In February 2001, after a discussion with his branch manager about information received from relatives concerning a withdrawal of funds from the Customer's account, Gallardo telephoned the Customer and asked her to close the account, misinforming her that he was no longer permitted to carry small accounts. In doing so he dictated a letter to the Customer in which she stated, in part, that she had been informed and updated on everything regarding her account by Gallardo. Further, this letter stated that "as has been the custom in the past, Fernando has been authorized by me to deposit and withdraw funds from my account." Days later, after speaking to a relative, she traveled to Puerto Rico and reviewed her account statements. The account had suffered severe losses. The Customer immediately filed a formal complaint with the Firm, in which she indicated that Gallardo did not have authorization to execute trades in her account.

13. While delivering her complaint to the Firm, the Customer was informed of a withdrawal of \$2,900 from her account. She had no previous knowledge of this withdrawal. The authorization for this withdrawal was merely initialed, not in her handwriting; the endorsement on the check issued to her by the Firm was not hers. She had not authorized the withdrawal. The Customer was not in Puerto Rico when the check was withdrawn from her account and deposited into Gallardo's personal checking account at a bank.

Outside Business Interest

14. Exchange Rule 346(b) states in relevant part, that "without making a written request and receiving the prior written consent of his member or member organization employer, no ... employee of a ... member organization shall at any time be engaged in any other business."
15. The Firm's Account Executive Compliance Guide, which Gallardo acknowledged having received, stated that "no employee may engage in, for personal investment, ... [an] outside business activity involving ... real estate ... without the prior written approval of the Director of Compliance."
16. In or about August 2000, a couple (the "Gs") opened an account with the Firm.
17. Thereafter, while employed by the Firm, Gallardo entered into a business venture with Mr. G involving the purchase of real estate in Puerto Rico.
18. Gallardo failed to disclose such outside business activity to the Firm.

DISCUSSION

According to Mr. Gallardo, this is the result of a family feud; family members were induced to complain about their accounts in the course of a family dispute. This may very well be. The issue before the Hearing Panel is the credibility of the relative who appeared before us. We found the testimony of the Customer who testified in this matter convincing.

Mr. Gallardo, in his Answer, claims that he gave the Customer \$2,900 in cash during her visit to Puerto Rico in March 2000, and that she in turn requested and endorsed a check for that amount from her account at the Firm, for deposit into Mr. Gallardo's bank account. But the evidence is compelling that the Customer was not in Puerto Rico at the time; her passport indicated no exit from or return to her country in that period. Nor did the Customer authorize the securities transactions in her account. The Customer did not assume that the funds in her account were at risk. When she sent \$7,000 into her account, in December 1999, she sent it as a "deposit", and further inquired whether funds already invested included "earnings". After 1999, she had no knowledge of investments made for her account, since the statements were addressed to a relative in Puerto Rico. Occasional telephone calls from Gallardo simply assured her that the

account was doing well. In February 2001, at the vehement behest of Gallardo, she wrote a letter indicating that Mr. Gallardo had kept her informed and updated on her account, and expressing thanks for his services. When she discovered the losses, days later, she complained.

As to the charge concerning his outside business interest, Mr. Gallardo claims that he was under no obligation to report a joint investment of funds with a customer, for the purpose of purchasing real estate, since no such purchase was actually made. But he certainly provided funds for the venture, and he certainly did not meet the requirement that the outside business activity be described in writing and approved by the Firm. Nor do we accept the claim that the real estate venture need not have been reported, since it did not materialize. The venture was reportable when funds for the investment were accepted.

DECISION

The Hearing Panel, by unanimous vote, found Mr. Gallardo guilty as charged.

PENALTY

In view of the above findings, the Hearing Panel, by unanimous vote, determined that Mr. Gallardo be censured and permanently barred from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization.

For the Hearing Panel

Milton M. Stein
Hearing Officer