

NEW YORK STOCK EXCHANGE, INC.

EXCHANGE HEARING PANEL DECISION 05-94

August 24, 2005

ROBERT LYNN CRAM

DIRECTOR OF COMPLIANCE AND GENERAL COUNSEL

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Permitted the recommendation and sale of variable annuities to customers that were unsuitable in view of the customers' investment objectives, investment experience, and financial resources and violated Exchange Rule 342 in that he failed to reasonably discharge his supervisory responsibilities: (a) as the Director of Compliance of his member firm employer; and (b) he failed to take actions reasonably designed to remedy violative conduct of his member firm employer that related to the supervision of variable annuities sales despite having notice of such conduct. – Consent to censure and six month supervisory suspension.

Appearances:

For the Division of Enforcement
Steven F. Korostoff, Esq.
Danielle I. Schanz, Esq.
Howard L. Kneller, Esq.
Steven M. Tanner, Esq.

For the Respondent
Joel S. Forman, Esq.

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A Hearing Panel of the New York Stock Exchange, Inc. (“Exchange”) met to consider a Stipulation of Facts and Consent to Penalty entered into between the Exchange’s Division of Enforcement (“Enforcement”) and Robert Lynn Cram (“Respondent”), Director of Compliance and General Counsel with David A. Noyes & Co., Inc. (the “Firm”). Without admitting or denying guilt, Respondent consented to a finding by the Hearing Panel that he:

- I. Engaged in conduct inconsistent with just and equitable principles of trade in that he permitted the recommendation and sale of variable annuities to customers that were unsuitable in view of the customers’ investment objectives, investment experience, and financial resources.
- II. Violated Exchange Rule 342 in that he failed to reasonably discharge his supervisory responsibilities:
 - (A) as the Director of Compliance of his member firm employer; and
 - (B) he failed to take actions reasonably designed to remedy violative conduct of his member firm employer that related to the supervision of variable annuities sales despite having notice of such conduct.

For the sole purpose of settling this disciplinary proceeding and without the Respondent admitting or denying guilt, the Division of Enforcement and the Respondent stipulate to certain facts, the substance of which follows:

Background and Jurisdiction

1. Respondent was born in 1953. During the period October 1999 through December 2001 (the "Relevant Period") and continuing through the present, Respondent has been the Director of Compliance and General Counsel of the Firm, a member organization of the Exchange. Respondent was first employed by the Firm in August of 1991.
2. In May of 2001, the Exchange commenced a Special Examination of the Firm (the "Special Examination"). In an examination report dated December 28, 2001 (the "Special Examination Report"), the Exchange's Division of Member Firm Regulation ("MFR") determined, among other things, that improper annuity switches, i.e., the purchase of an annuity with the proceeds of the sale of an existing annuity, were occurring at a branch office of the Firm formerly located in Wausau, Wisconsin (the "Branch") and that the Firm was inadequately supervising such switches.
3. By letter dated May 2, 2002, the Firm was notified that the Exchange had commenced an investigation concerning annuities sales and supervision based on certain of the exceptions contained in the Special Examination Report.
4. Thereafter, the Firm responded and certain of its employees and officers provided testimony concerning the Exchange's investigation into annuities sales and supervision at the Firm.
5. On March 19, 2003, Respondent appeared with counsel and provided certain testimony concerning the Exchange's investigation into annuities sales and supervision at the Firm, including testimony involving his role at the Firm and his knowledge concerning the execution of annuities switches at the Branch.

Summary

6. During the period October 1999 through December 2001, Respondent was the Director of Compliance and General Counsel of the Firm. He engaged in conduct inconsistent with just and equitable principles of trade and violated Exchange Rule 342 in that he permitted and failed to reasonably supervise the execution of approximately 125 variable annuities switches to customers, the majority of which were unsuitable. This conduct occurred despite the fact that he (a) had knowledge of regulatory activity that occurred prior to and during the Relevant Period with respect to the improper sale and supervision of annuities at the Branch, and (b) had received written and verbal warnings concerning improper annuities sales and supervisory practices that were made by an employee of the Firm to Respondent and other members of the Firm's senior management.

Annuity Sales and Supervision

Introduction

7. During the Relevant Period, the Firm, through its registered representatives at the Branch, including BOM, the producing Branch Office Manager thereof, recommended and executed approximately 125 variable annuity switches on behalf of customers.
8. Many annuities, including those sold at the Branch, have substantial “surrender” fees that are assessed if the purchaser of the annuity decides to “cash in” the investment within a number of years of after they are purchased. Such fees often constitute up to eight percent of the investment principal if the annuity is redeemed during the first year after it is purchased. Thereafter, such fees often decrease by one percent per year.
9. As a result of, among other things, the aforementioned surrender fees, annuities are generally viewed as long-term investments.

Regulatory History and the Adoption by the Firm of Written Policies Concerning Annuity Sales

10. In January 1998, MFR conducted an examination of the Firm. In a report issued to the Firm in March of that year, MFR concluded that there were annuity switches at the Branch that had substantial surrender charges and that the Firm violated Exchange Rule 342 by, among other things, failing to have appropriate written procedures relating to such annuity switches.
11. A 1998 examination of the Firm by the Securities and Exchange Commission (the “SEC”) resulted in a letter being sent to the Firm by the SEC concerning the Firm’s lack of certain written procedures governing annuity switches, as well as an uncorrected exception from a prior examination by the National Association of Securities Dealers (the “NASD”) that related to the fact that BOM was not reviewing customer annuity applications submitted by other registered representatives in the Branch.
12. Thereafter, a number of the issues raised by MFR’s 1998 examination were referred to Enforcement for investigation.
13. Following such investigation, Enforcement and the Firm agreed to settle the aforementioned matter. On or about September 22, 1999, on consent, an Exchange Hearing Panel found that the Firm violated Exchange Rule 342 by failing to, among other things:
 - a. Maintain written procedures relating to the sale and supervision of annuities as well as the review of its annuity business for use during branch office audits;
 - b. Maintain procedures to monitor the number or frequency of annuity switches;

- c. Prevent its registered representatives from effectuating annuity switches without supervisory review for completeness, accuracy and suitability; and
 - d. Maintain a master list of annuity switches, thus allowing for the creation of exception reports by which to monitor whether an excessive number of switches were occurring.
14. The Hearing Panel imposed a censure, a fine of \$60,000 and an undertaking relating to certain other matters in the case. (Hearing Panel Decision 99-132.) Respondent appeared on behalf of the Firm in connection with the matter.
 15. In March of 2000, in response to the aforementioned Exchange disciplinary action, the Firm created certain written procedures regarding annuity switches (the "March 2000 Procedures").
 16. The March 2000 Procedures mandate the following multi-part approval process with respect to variable annuity switches that are effectuated at the Firm:
 - a. First, all annuity switches have to be approved by a Branch Office Manager before they are submitted to the issuing company.
 - b. Second, where the surrender charge of an annuities contract (1) exceeds \$5,000, or (2) is three percent or more of the investment principal, the transaction has to be further approved prior to submission to the issuing company, by the Firm's National Insurance Manager or National Sales Manager.
 - c. Third, if any funds are withdrawn within the first two years, and are to be reinvested, further approval as set forth above is required.
 17. On or about February 16, 2001, the SEC sent a letter to the Firm following an examination of the Firm's books and records. The SEC stated in this letter that improper annuity switches were continuing and that the Firm was not adequately supervising such switches. The SEC also stated in this letter that many customer files at the Branch did not contain information concerning such customers sufficient to assess whether the annuity switches at issue were suitable.
 18. In February 2001, MFR and the NASD conducted a joint examination of the Firm's compliance with financial and operational requirements. In a report issued on April 2, 2001, MFR found, among other things, that the Firm violated Exchange Rule 342 by failing to adhere to its own annuity approval process.
 19. In May of 2001, the Exchange commenced the Special Examination of the Firm. As set forth above, the Special Examination Report indicated, among other things, that improper annuity switches were occurring at the Branch and that the Firm was inadequately supervising such switches.
 20. In his capacities as the Firm's Director of Compliance and General Counsel during the Relevant Period, Respondent had actual knowledge of the aforementioned regulatory activity and was responsible for coordinating and supervising the

implementation of the Firm's response to such activity. He therefore was on notice that unsuitable and improperly supervised annuity switches were occurring at the Branch during such time.

Unsuitable Annuity Switches

21. In his capacity as the Branch Office Manager of the Branch, BOM was responsible for submitting approval request forms for annuity switches at the Branch as required under the March 2000 Procedures.
22. BOM failed to submit requests for the approval of annuity switches as required under the March 2000 Procedures. Moreover, BOM acted to intentionally evade the requirements of the March 2000 Procedures so as to cause annuity switches to be effectuated at the Branch that were not subject to appropriate supervisory review.
23. Moreover, many of the annuity switches that occurred at the Branch during the Relevant Period were switches of original annuity contracts that had been held for only a few years or less, thus causing the customers involved to incur substantial surrender fees, other charges and increased expenses in connection with such transactions.
24. The imposition of the aforementioned surrender fees, charges and increased expenses rendered such annuity switches to be financially disadvantageous to the customers involved. Accordingly, the majority of the approximately 125 annuity switches that were executed at the Branch during the Relevant Period were unsuitable.

Additional Notice To Respondent And Other Members Of The Firm's Senior Management of Unsuitable Annuity Switches From A Firm Employee

25. At all relevant times, IM was the Firm's National Insurance Manager. Prior to and subsequent to the adoption of the March 2000 Procedures, IM sent a number of memoranda to the Firm's senior management complaining in substance that annuity switches were being executed at the Branch that were not in the best interests of the customers involved. Respondent received certain of these memoranda.
26. With respect to the aforementioned memoranda sent by IM subsequent to the adoption of the March 2000 Procedures, such memoranda further indicated in substance that IM was not receiving approval requests from the Branch that were required under the March 2000 Procedures.
27. Also, during the period 1998 through 2001, IM spoke with the Respondent and other members of the Firm's management on a number of occasions concerning annuity sales at the Firm. During a number of these discussions, IM advised the aforementioned individuals about his concerns as set forth above.
28. As a result of the aforementioned communications by IM to Respondent and other members of the Firm's senior management, Respondent had notice that unsuitable and improperly supervised annuity switches were occurring at the Branch.

Supervision

29. As the Firm's Director of Compliance, Respondent, who was involved in formulating the Firm's response to the foregoing supervisory deficiencies, had an obligation to take reasonable steps to ensure that the Firm, its employees and associated persons complied with applicable federal securities laws and regulations, as well as Exchange rules.
30. He therefore had an obligation to take steps that were reasonably calculated to ensure that the Firm corrected the aforementioned supervisory deficiencies with respect to the execution of unsuitable annuity switches at the Branch.
31. Despite the foregoing and with respect to the above, he failed to reasonably execute his responsibilities as the Firm's Director of Compliance during the Relevant Period.
32. For example, the aforementioned Hearing Panel decision noted that the Firm failed to maintain a master list of annuity switches, thus allowing for the creation of exception reports. Despite the fact that he was responsible for the creation of such a list, it was never created.
33. In addition, pursuant to Firm policy, Respondent was responsible for performing annual compliance audits of the Firm's branch offices. The purpose of such compliance audits was, among other things, to determine whether the Firm's branch offices were complying with internal Firm policies and procedures, as well as applicable regulatory requirements. Respondent conducted compliance audits of the Branch in September of 2000 and November of 2001.
34. Nonetheless, despite conducting such compliance audits, Respondent failed to detect that for the annual periods reviewed during the audits, BOM had neither requested nor received further supervisory approval as required by the March 2000 Procedures for almost all of the annuity switches that occurred during such period. Respondent further failed to detect that the few approvals that were requested were not made prior to the time that such transactions were submitted to the issuers of relevant annuities.
35. Had Respondent reasonably executed his responsibilities as the Firm's Director of Compliance, the Firm may have prevented the execution of the unsuitable annuity switches at issue.
36. As set forth above, Respondent was on notice of the aforementioned violative conduct concerning annuities sales at the Branch. In addition, based on his role as a member of the Firm's senior management, he had the ability and authority to take steps that were reasonably calculated to prevent the violative conduct from continuing. Nonetheless, he failed to do so.
37. Based upon the foregoing, Respondent permitted the recommendation and execution of variable annuity switches on behalf of customers that were unsuitable in view of the economic merit of such transactions, as well as the customers' investment objectives, investment experience and financial resources.

DECISION

The Hearing Panel, in accepting the Stipulation of Facts and Consent to Penalty, found Respondent 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 Respondent of a censure and a six month supervisory suspension. In support of this penalty, Enforcement relies on the following precedents: In the Matter of Mark Peters, HPD 99-161 (November 18, 1999) a branch office manager consented to a censure, 30 day plenary suspension, and thereafter, six month suspension as director of compliance, In the Matter of Lewis Henry Echlin III, HPD 01-208 (November 20, 2001) a former branch office manager consented to a censure, five month supervisory suspension, a \$10,000 fine and a requirement to retake and pass the appropriate examination prior to seeking employment in a supervision capacity and In the Matter of John H. Gutfreund et. al. 51 S.E.C. 93 (December 3, 1992) which concerned three senior members of their firm who were the subject of action by the Commission. In addition, that firm's chief legal officer was not disciplined but was the subject of a related report pursuant to section 21 (a) of the '34 Act. The chief legal officer was also responsible for the Compliance Department. The Commission found that he had not been a direct supervisor of the person at issue in that matter.

The Respondent here was not disciplined simply because he held the title of Compliance Director or General Counsel. Holding such a title does not automatically make one a supervisor under Exchange Rule 342. Rather he was named and properly disciplined because he had lapses of personal responsibility. Whether a Compliance Director or General Counsel is or becomes a supervisor is a fact based analysis. Here Enforcement and the Hearing Panel are convinced that the Respondent undertook certain specific responsibilities concerning BOM and failed to perform them. He also was personally and specifically put on notice by IM of problems for which he had undertaken an oversight relationship. He is therefore before the Hearing Board because he had become, as to specific problems, a failed supervisor. The penalty consented to is within the range of the precedents cited and is appropriate and not excessive considering the facts and circumstances herein.

For the Hearing Panel

Vincent F. Murphy - Hearing Officer
Panelists:
Norman Marcus
William B. Peterson, Esq.