



| | | |
|----------------------|---|-----------------------|
| In the Matter of |) | Request for Review of |
| |) | NYSE Hearing Board |
| |) | Decision 07-24 |
| Luis Miguel Cespedes |) | |

In accordance with NYSE Rule 476(f), after a consideration of the record in this matter, written submissions filed by the parties and oral argument, the Board affirms the decision of the Hearing Panel in all respects.

January 30, 2008

By the Board of Directors
NYSE Regulation, Inc.

NEW YORK STOCK EXCHANGE LLC

NYSE HEARING BOARD DECISION 07-24

July 3, 2007

LUIS MIGUEL CESPEDES

FORMER REGISTERED REPRESENTATIVE

* * *

Violated NYSE Rule 476(a)(6) by recommending and effecting in customers' accounts transactions that were unsuitable in view of customers' age, retirement status, financial resources, or financial experience – Censure and ten-year bar.

Appearances:

For the Division of Enforcement

Linda Riefberg, Esq.

Danielle I. Schanz, Esq.

Ronald Sannicandro, Esq.

Kelli Stieh, Esq.

Dana Yoon, Esq.

For Respondent

Jonathan Schwartz, Esq.

* * *

A Hearing Panel on behalf of the New York Stock Exchange LLC (“NYSE”) considered a Charge Memorandum issued by NYSE Regulation, Inc.’s Division of Enforcement (“Enforcement”) charging Luis Miguel Cespedes (“Respondent”), a former registered representative with A.G. Edwards & Sons, Inc. (the “Firm”), a member organization, with having:

- I. Violated NYSE Rule 476(a)(6) by engaging in conduct inconsistent with just and equitable principles of trade in that he recommended and effected, in the accounts of one or more customers, transactions that were unsuitable in view of each such customer’s age, retirement status, financial resources and/or financial experience.
- II. Violated NYSE Rule 476(a)(6) by engaging 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 organization employer.

Respondent filed an Answer, in which he admitted some of the allegations in the Charge Memorandum and denied others.¹ Enforcement thereafter filed several motions: (1) a motion regarding service by facsimile or e-mail and for additional witness information; (2) a motion to take videotaped testimony; and (3) a motion to admit taped conversations. After briefing by the parties for each of the motions, the Hearing Officer issued an order resolving those motions; the order is attached as Appendix A.

Based on the pleadings, the evidence, and argument presented at the hearing, the Hearing Panel made the following findings:

Background and Jurisdiction

2. Respondent was born in [REDACTED]. He entered the securities industry in October 1989 when he joined Non-Member Firm A. Respondent remained there until May 1994, when he joined the Firm and became registered with the NYSE. He was asked to resign from the Firm in October 2001. He thereupon joined Non-Member Firm B, an NASD member firm, where he is currently employed.
3. On or about October 12, 2001, the NYSE received a Uniform Termination Notice for Securities Industry Representatives, or “Form U-5,” from the Firm reporting the complaints of customers YG, the Fs, and CD against Respondent. Approximately 18 other customer complaints against him followed.
4. As of September 2005, the Firm had settled with 15 customers for a total amount of approximately \$1.08 million. Respondent contributed \$20,000 to one of the customer settlements, namely, the settlement with JJ, MJ, and LJ.
5. By letter dated March 22, 2002, which he received, Enforcement informed Respondent that it was investigating this matter.
6. Thereafter, represented by counsel, Respondent appeared and testified in connection with Enforcement’s investigation.

Overview

7. As set forth below, while employed at the Firm from approximately 1994 through 2001 (the “Relevant Period”), Respondent recommended and effected, in over 20 accounts belonging to 20 individual customers, transactions—including transactions on margin—that were unsuitable in view of the customers’ investment objectives, investment experience, or financial resources, among other factors.

¹ In his Answer, Respondent did not expressly deny each of the Charges set forth in the Charge Memorandum, as is required under NYSE Rule 476(d). Nevertheless, he was deemed to have denied the Charges, in light of his actions in contesting this matter.

Unsuitable Trading in Customer Accounts

8. During the Relevant Period, Respondent was his branch's top producing registered representative, with approximately 400 to 500 clients and 1,000 accounts. Respondent recommended and purchased for many of his customers technology-sector Unit Investment Trusts ("UITs"), often on margin, resulting in these customers' accounts' being overconcentrated in technology investments and, in several instances, with an unsuitable use of margin.
9. UITs are baskets of 5 to 30 stocks or bonds available in several asset classes and risk/reward categories. Rather than buying individual shares of stocks, the purchase of units of UITs gives one ownership of a proportional share of the stocks in the UIT portfolio. UITs are contracts that mature in either several months or up to five years.
10. Many of Respondent's customers were invested in UITs containing a basket of technology securities, as well as UITs containing baskets of securities of particular technology subsectors, such as semiconductors, cable TV, wireless communications, internet content, or software. Over the Relevant Period, these securities were highly volatile. Moreover, Respondent made many of these investments on margin, which increases the risk of the investment in two ways: (1) the customer may lose more than the amount she invested if the value of the security depreciates sufficiently, giving rise to a margin call in the account; and (2) the customer is required to incur the cost of margin interest, which increases the amount by which her investment must appreciate before she realizes a net gain. Stephen Thorlief Rangen, Exchange Act Release No. 38,486, 64 S.E.C. Docket 628, 1997 WL 163991, at *3 (Apr. 8, 1997).
11. Respondent recommended significant quantities of UITs to customers who were retired, elderly, unsophisticated, and of modest means, resulting in these customers' accounts' being overconcentrated in technology investments, often in connection with an unsuitable use of margin, based on the customers' financial resources, investment experience, and investment objectives.

Transactions in the Account of Customer LP

12. Three transactions occurred in the account of LP on June 28, 2001, when Respondent was traveling out of the country. Enforcement alleged that these transactions were executed without authorization by Respondent's customer, LP.

DECISION

Charge I: Unsuitable Trading

Pursuant to NYSE Rule 476(a)(6), a registered representative has an obligation to "make only such recommendations as would be consistent with [his customer's] financial situation and needs," taking into account such factors as the customer's stated investment objectives, age, net worth, income, and level of sophistication. See Rangen, 1997 WL 163991, at *4 (internal quotation omitted) (making finding of unsuitability where respondent recommended purchase on

margin of zero-coupon U.S. Treasury securities and over-the-counter stocks for elderly, retired customers whose objective was “safe, income-producing investments”); see also Justine Susan Fischer, Exchange Act Release No. 40,335, 72 S.E.C. Docket 2077, 67 S.E.C. Docket 1753, 67 S.E.C. Docket 1758, 1998 WL 484111, at *6 (Aug. 19, 1998). As the Firm itself stated in an internal policy:

A security which is suitable for one investor may be unsuitable for another; the “wholesale” recommendation of a security is unlikely to be suitable for each client. An obvious violation of the suitability rule is the recommendation of extensive trading in a long term growth account or solicitation of highly speculative securities in an account where the stated objective is income and stability of principal.

Enforcement Exhibit (“Enf. Ex.”) 72 at 4.

UITs Involve Increased Risk

As mentioned above, one investment vehicle that Respondent favored for many of his clients was unit investment trusts or “UITs.” See Hearing Transcript (“Tr.”) at 348. UITs may involve increased risk as compared with other pooled investments for a number of reasons. First, UITs tend to be riskier than mutual funds because, unlike a mutual fund, a UIT is not actively managed and generally expires on a specified future date. Enforcement’s expert testified as follows:

[E]ach [UIT is] ... discreetly organized and fixed, in terms of the size, duration and composition. One of the things that’s unique about a UIT is that the assets in the trust don’t change. They stay fixed over the life [of the UIT], so there’s no ability to rebalance or adjust or otherwise hedge within the trust. It’s a defined portfolio.

Tr. at 404. A UIT has no fund or investment manager monitoring the value of the underlying securities and, thus, there is no one available to act in the event of a steep decline in that value—other than the registered representative or the customer herself.

Moreover, most of the UITs that Respondent purchased for his customers were focused on only one sector of the economy and, often, it was the highly volatile technology sector. Accordingly, the company from which Respondent purchased virtually all of the UITs in which he invested his customers gave the following warning to customers in its promotional material:

[Our] equity portfolios invest in as few as 5 stocks to as many as 50 with the typical portfolio consisting of 25 to 30 stocks. Because the portfolios place such an emphasis on concentration, many of the portfolios are subject to additional risks. For instance, portfolios that are heavily weighted in only a few stocks or portfolios that are focused on only one sector involve increased

volatility. You should consider investing in more than one sector or pairing these types of portfolios with more diversified investments, in your overall portfolio.

Enf. Ex. 34 at 7 (Bates No. NYSE 04973) (emphasis added).

Respondent's Trading Resulted in an Unsuitable Overconcentration in Technology UITs

The Panel considered documentary evidence, testimony, or both concerning the trading done by Respondent in the accounts of the 20 different customers at issue. The evidence showed that, from 1994 through 2001, and especially during the 1999 to 2001 timeframe, Respondent invested all 20 of these customers into UITs, primarily in the technology sector. In fact, Respondent's former assistant testified that Respondent would often buy or sell the same UITs for multiple customers. See Tr. at 298-99.

The Hearing Panel found that Respondent engaged in unsuitable trading in the accounts of all 20 customers at issue in this case.

Customer YG

In January 2000, YG was a 56-year-old dispatch clerk with a high school education. Just prior to that time, she had elected to receive from her employer a lump sum payment of approximately \$173,000 in lieu of a pension, as a result of her company's merger with another; over the years, she had also accumulated stock in her former company through a payroll deduction plan. A work friend of hers, DA, who was also a customer of Respondent's, suggested that YG open a brokerage account with Respondent. When YG and Respondent first spoke, he suggested that he could generate returns of 10 to 15% annually, but he did not specify the types of securities he would purchase on her behalf.

YG opened two accounts with Respondent at the Firm in January 2000, an IRA account and an individual account. According to her new account documents, at the time, she had a total liquid net worth of \$260,000 and an annual income of \$35,000. Her January 2000 account documents also indicate that she had 20 years of experience with stocks and bonds and that she had an investment objective of "Taxable Income – Aggressive," which was listed as her first objective out of four. However, YG testified that the reference to "20 years" was merely based on the fact that she had been acquiring stock in her company for about 20 years through payroll deductions; in reality, she had no experience whatsoever with investing. See Tr. at 55-56. Moreover, she now understands the difference between an "aggressive" and a "conservative" investment and would have listed "Growth – Conservative" as her investment objective in January 2000, had she understood what "Aggressive" actually meant. Id. at 55, 67.²

YG testified that she did not know what a UIT was, although she had heard the term and now believed, based on legal advice she had received, that UITs were "a terrible thing for [her] to be

² Her account documents show that her primary objective was indeed changed to "Growth – Conservative" in update documents dated July 10, 2001 and February 21, 2002. See Enf. Ex. 25 at Bates Nos. NYSE 05341, 05343.

invested in.” Tr. at 56. She said that Respondent never discussed UITs with her. She also stated that she frequently called Respondent when her account balance began dropping, but he usually failed to call her back; and when they did speak, he would make her “feel like [she] was asking stupid questions...” Id. at 59. Respondent further increased the risk to which YG was exposed by having her take on a margin balance in her individual account.

YG’s account statements revealed a constant overconcentration in technology and other risky UITs throughout 2000 and the beginning of 2001. For example, by the end of January 2000—the very month in which she opened her individual account—UITs already accounted for 99.8% of her net account value, and more than half of those UITs contained holdings in the biotech or communications sector; by the end of November 2000, the UIT portion of her account was down to 65.9%, but almost all of the UITs were now in the technology or pharmaceutical sectors; and by February 2001, UITs—all of which were in the technology sector—represented 113.8% of the value of her portfolio, as a result of the use of margin in her account. See Enf. Ex. 25.

The situation was similar in her IRA account. In April 2000, UITs accounted for 71.5% of her holdings, and more than half were in the technology or pharmaceutical sector. By the end of February, Respondent had 75.8% of YG’s IRA invested in UITs, virtually of which were in the technology, communications, or biotech sector. Id.

The Hearing Panel found that the high concentration of YG’s portfolio in UITs containing technology and other highly volatile securities, especially when combined with the use of margin debt, was unsuitable for her, based on her age, her conservative investment objectives, and her relatively limited grasp of investing in general.

Customer EK

In 1994, when EK opened her accounts with Respondent, she was a 69-year-old housewife with a high school education. Prior to 1994, she had held a brokerage account with another member firm and had purchased stocks with her husband “every once in a while” from the time they were married. Tr. at 83. She recalled that she and her husband suggested stocks to Respondent on occasion, but generally, Respondent was the one who made investment recommendations and, in particular, recommendations for “other kinds of investments, the different funds, [since she and her husband] had no knowledge of anything like that.” Id. at 89. In connection with the opening of her account, she signed a margin agreement; however, she did not know what margin was and only found out about the margin in her account around 1999, when she realized she was paying interest for money that she had been withdrawing on a regular basis. She still has no idea what a UIT is. She further testified that Respondent never discussed margin or UITs with her and that she never asked Respondent to trade on margin or to invest in UITs on her behalf. Id. at 90-92, 106.

In early 1999, EK’s individual account contained a mix of diversified equities (which represented 62% of her account value), bonds (which accounted for about 16%), mutual funds (which represented about 4%), and other securities, such as financial sector UITs (just under 18% of her account value). By the year 2000, however, the account statements for EK’s individual account show an excessive concentration in the technology, biotechnology, and

telecommunications sectors, with an additional overemphasis on UITs. For example, in June 2000, over 75% of her net account value was held in technology, biotechnology, and telecommunications securities, including 72.3% of her total net account value in UITs from those sectors. The overall picture was even worse at the end of December 2000: UITs, primarily in the technology sector, had increased to almost 84% of the net value of her account. A similar pattern was observed in EK's IRA account, which went from having no UITs, 77% equities, and 23% mutual funds in early 1999 to having 99.7% technology UITs by early 2001. See Enf. Ex. 24. For someone then in her mid 70's, who had no employment income and only a limited pool of liquid assets beyond what was in her brokerage accounts, this high concentration in such volatile investments was clearly unsuitable.

Customer DA

When DA met Respondent in 1995, she was a 61-year-old, divorced dispatch clerk with a high school education. She earned approximately \$32,000 per year and was about to take an early retirement. Her only assets were the stock in her company that she had acquired through a payroll deduction plan—which totaled approximately \$200,000 at the time of her retirement—and the equity in the home that she owned at the time. She told Respondent that her goal was to have “a little growth,” but that she also “needed to have a bit of security because that’s all [the money she] had.” Tr. at 129. When she opened her accounts, she never asked for a margin line of credit; in fact, at the time, she did not even understand what margin was, and Respondent never discussed the concept with her, but he nevertheless had her sign a margin agreement and, ultimately, made many investments on her behalf using margin. It was only when she contacted an accountant—whom she found in the telephone directory—to discuss a tax issue that she discovered the risk that came with carrying margin debt. Id. at 140. And when she asked Respondent to sell some of her stock holdings to pay off her margin balance, he resisted her instructions and got “upset” with her. See id. at 156, 164. She now understands what margin is and testified that, had Respondent explained the risk that came with the use of margin—namely that, if the stock in her account went down, she might end up owing the Firm money—she would never have agreed to use margin in the first place. Id. at 172.

As for the particular investments in her accounts, her knowledge was also limited. For example, in all the years she was with Respondent and the Firm, she never heard the term “UIT” or “unit investment trust.” Id. at 131. And despite having signed an options agreement, DA credibly testified that she “d[idn’t] know anything about options.” Id. at 145.

Moreover, testimony from DA and from Respondent’s former assistant suggested that Respondent caused assets held in Respondent’s IRA account to be distributed into her individual account, which would have triggered a significant tax liability, had the Firm not agreed to reverse the transfer. See id. 134-35; 239.

Account statements from 1999 through 2000 for DA’s individual account consistently reflect relatively large margin balances, which were generally used to purchase technology stocks and UITs. For example, at the end of June 2000, her margin balance was \$72,475, which represented 76.4% of the total net value of her account; meanwhile, the two equity positions in her account, both of which were technology stocks, represented 167.7% of her net account value, with

another 8.7% in technology UITs. By the end of September 2000, Respondent had sold off one of DA's equity positions and had exacerbated the risk by creating an overconcentration in technology and telecommunication UITs, which now represented 117.6% of DA's net account value due to the use of margin. See Enf. Ex. 31. For a retiree in her mid 60's who did not understand the concept of margin or UITs, such high concentrations in such volatile investments—not to mention the excessive use of margin—constituted completely unsuitable trading on the part of Respondent.

Customer CD

In 1995, when CD first met Respondent, she was working as the marketing director of a small architectural firm. It was during that year that Respondent became the registered representative responsible for managing her firm's profit-sharing plan.

In January 2000, when CD was in her early 60's,³ she received a severance payment of \$120,000 from her firm, which she deposited into an individual account that Respondent was managing for her; several months later, having sold her house, she deposited an additional \$66,000 from the proceeds of that sale. Tr. at 850. She testified that the funds she invested with Respondent represented "a hundred percent" of her liquid net worth. Id. at 860. And other than her experience with the firm's profit-sharing plan, she had had no experience investing in securities. Id. at 849. Furthermore, she testified that her objective was to safeguard the value of her investments. At a meeting she had with Respondent around the time of the first deposit in January 2000, she made it clear to Respondent that the funds that she was entrusting to him had to be kept safe because she was depending on them as a source of income. In her words:

I just told him that this, he had to understand, this was my nest egg. I think I said this is my nut, and it's got to be protected, it just has to be. This is it. I'm kind of done, I mean, you know, my circumstances leaving [my firm] w[ere] sort of devastating because I thought I had a career for life. My first career. And so I just said: This is it, I'm done.... I wasn't going to go to another architectural firm or something like that, I was going to just start my own little business and just kind of plod along and use this as ...[a] big part of my income.

Id. at 853. She specified that, eventually, she intended to withdraw about \$1,500 per month from the account. Id. at 854. When she began to make the \$1,500 monthly withdrawals in September 2000, she believed that she would have enough capital gains to generate the cash she needed and that her capital positions would be liquidated as appropriate to cover the withdrawals; instead,

³ CD acknowledged during direct examination that she had misrepresented her age when filling out certain forms, including her new account documents, by claiming to be 10 years younger than she was. She stated that, other than for insurance forms, she always listed her birth year as 1948, rather than her actual birth year of 1938, as a form of "protection" against competition from younger employees. Tr. at 845-46. However, she testified that, although she never explicitly discussed the matter with Respondent directly, in the summer of 2000, she did contact Respondent's secretary and asked for the birth year in her account records to be corrected. Id. at 861.

the withdrawals actually accumulated as margin debt, unbeknownst to CD. Id. at 915-16. Furthermore, Respondent never discussed UITs with CD, and she did not come to understand what they were until she moved her account to a different firm. Id. at 854.

Despite his failure to explain the risks of his aggressive trading strategy, Respondent invested almost all of CD's funds into UITs as soon as those funds had been turned over to him in early 2000. By the end of May 2000, UITs accounted for 89.9% of the individual account's net value, and a full three quarters of those UITs were in the technology or pharmaceutical sectors. By the end of February 2001, the overconcentration had become extreme: UITs represented 193% of the net value of CD's account, due to her margin balance of almost \$54,000, and all but one of the 13 UITs in her portfolio were in the technology sector, including several different semi-conductor UITs. See Enf. Ex. 23. The Panel believes that such a high concentration of assets in such a volatile sector, particularly when combined with the sizeable margin balance that Respondent incurred, was unsuitable.

As a purported defense, Respondent contended that CD "was very assertive about her investment needs and she was aggressive." Tr. at 666. When asked what CD's investment goals were, Respondent testified:

At no time did she want to invest conservatively or in bonds. This lady is not your typical [customer], she doesn't lay back and let things happen. She takes charge of[f] her life. And she did not want to have a bond or a very conservative portfolio because it wouldn't meet the needs for her lifestyle.

Id. at 673.

A customer's stated investment objectives or expectations, however, are only one consideration in a suitability analysis. A broker, in arriving at specific recommendations for his customer, must also consider the customer's overall circumstances, including her net worth, employment status, annual income, and level of understanding of the various investments available; and if such factors would lead a reasonable broker to conclude that the investment strategy requested by the customer is too risky for her, the broker must do everything in his power to discourage her from undertaking such a strategy. See Clyde J. Bruff, Exchange Act Release No. 31,141, 50 S.E.C. 1266, 52 S.E.C. Docket 1266, 1992 WL 224091, at *3 (Sept. 3, 1992) ("even if the [customers] wished to engage in aggressive and speculative options trading, [the broker] was obliged to counsel them in a manner consistent with their financial situation"). Thus, even assuming CD explicitly requested an aggressive trading strategy, we find that Respondent failed to consider other aspects of CD's financial profile that made the strategy he pursued on her behalf unsuitable.

Moreover, the Panel found Respondent's testimony regarding CD's aggressive investment objectives unreliable. While there was evidence that CD had occasionally purchased stocks on her own initiative, including relatively risky penny stocks on a Canadian exchange, those investments represented only a small fraction of CD's net worth. We simply do not believe Respondent's self-serving hearsay testimony to the effect that CD essentially demanded that

virtually all of her portfolio be invested, on margin, in technology UITs. On the contrary, CD credibly testified that she did not understand what UITs were and that Respondent kept telling her just to “trust” him and allow him to continue to invest in technology UITs on margin, even as the value of her investments was declining rapidly. Tr. at 860. And although she acknowledged that she understood that “margin” constituted a loan, she testified that she was not aware, at the time, that she could be required to write a check to the Firm to cover the margin balance in the event that the value of her stocks went below a certain level. Id. at 857.

On the record before us, we reject Respondent’s claim that CD, a woman in her 60’s⁴ who had just left her employment and was embarking on a new career as a small business owner, insisted that Respondent undertake an investment strategy that resulted in an extreme concentration of almost all of her net worth into UITs and, primarily, technology UITs, many of which were purchased on margin. On the contrary, we believe that Respondent misled CD as to the risks of the investments he was purchasing on her behalf and, had she understood those risks, she would never have consented to the investment approach that Respondent was pursuing in the first place.

In light of the above, the Panel concluded that Respondent engaged in unsuitable trading in CD’s accounts.

Customer MA

In 1999, MA was in her late 40’s and earned approximately \$45,000 a year working as an administrative assistant at her local high school, where she had worked since 1985. She had no experience with investments other than her school’s 403B retirement plan. Her husband at the time, whose annual income was around \$45,000 a year, had an account with the Firm that had been taken over by Respondent. On occasion, the latter would come to MA’s home to discuss her husband’s account and it was during those occasions that she had come to know Respondent.

During the year 1999, both of MA’s parents passed away, and by the end of that year, she was expecting an inheritance of several hundred thousand dollars. She was very concerned because she had never been responsible for that much money before—until that point, she had less than \$10,000 in savings—and she, therefore, felt that she needed financial advice, which Respondent offered to give her. Tr. at 952. In December 1999, he prepared a handwritten summary of his suggestions for her, which included UITs, but she does not recall his ever explaining or even mentioning UITs. See id. at 956-57; see also Enf. Ex. 101.

In February 2000, after setting aside just over \$50,000 to pay bills, she turned over approximately \$220,000 to Respondent, which was the balance of her inheritance. These funds represented most of MA’s liquid net worth. Tr. at 959-60. She recalled clearly conveying to Respondent her conservative investment objectives; in her words, she told him: “I wanted a well-

⁴ While the Panel recognizes that Respondent may not have known CD’s correct age, we note that age is but one factor in a suitability analysis. In the instant case, we find that CD’s misrepresentation regarding her age had no impact because the high-risk strategy that Respondent employed would have been unsuitable for CD based on other factors, such as her net worth, her lack of sophistication, her lack of employment, and her stated investment objectives, even if she had been in her 50’s, rather than her 60’s, during the Relevant Period.

diversified account. I wanted to make money but I didn't want to lose my principal no matter what." Id. at 958.

Nevertheless, Respondent immediately invested all of MA's funds into UITs, the majority of which were in the technology, biotechnology, and pharmaceutical fields, such that, by the end of March 2000, UITs represented about 103% of the net account value, due to a small margin balance. By the end of September 2000, Respondent had sold off certain financial-sector UITs purchased earlier that year in favor of additional technology UITs, which focused on semiconductor and wireless technology. The following month, he purchased even more technology UITs, this time with a focus on internet, semiconductor, and other technology companies. By the end of October, UITs represented 137.5% of the account's value, due to a growing margin balance. See Enf. Ex. 30.

During the year 2000, MA's husband became very ill, which she believes she or her husband told Respondent, see Tr. at 962, and her husband retired. This made the safeguarding of MA's capital even more critical. Yet Respondent never altered his trading approach—instead, he continued to purchase larger and larger positions in technology and other speculative UITs. Moreover, MA was writing periodic checks on her account to pay various bills, including a \$19,000 check to purchase a car for her son, and she thought that Respondent was liquidating investments to free up the cash necessary to cover those checks. See id. at 963-65. In fact, Respondent was not liquidating the investments as agreed; as a result, the checks were coming directly out of MA's margin loan, putting her further and further into debt during the year 2000 and the first half of 2001. See Enf. Ex. 30.

For a woman with an annual income of \$40,000, no experience with investing to speak of, a gravely ill, retired husband, and a stated desire to safeguard her capital, it was completely unsuitable for Respondent to place virtually all of MA's liquid assets into highly speculative technology UITs, and even worse, to do so with an ever-increasing margin balance.

The G Family

In the early 1990's, the G family was comprised of a middle-aged couple and their three young adult daughters. It was around that time that Respondent opened several accounts for them, including a joint account for the parents, an individual account for the wife, and individual and IRA accounts for the three daughters. In addition to some modest savings, the Gs received a cash settlement as a result of a law suit against an industrial manufacturer that had caused environmental pollution in the area in which they lived. See Enf. Ex. 89 at 12. The family turned over some of those settlement funds to Respondent so that he could invest them. See id.; Enf. Ex. 87 at 25.

In each of the Gs' accounts, the Panel observed the same kind of overconcentration in technology-sector UITs as observed in the accounts of the customers described above.

For example, in the year 2000, AG, the eldest daughter, was 36 years old, held a degree from a junior college, and had an annual income of approximately \$36,000. Enf. Ex. 87 at 5, 20. Respondent handled both an individual and an IRA account on AG's behalf, and she relied

entirely on Respondent's recommendations because she had virtually no understanding of the investing world. For example, she testified that she still does not know what a UIT or "unit investment trust" is, and she did not recall Respondent's ever discussing UITs with her. Enf. Ex. 87 at 22. Yet despite her lack of sophistication and her relatively small net worth, Respondent had AG heavily invested in UITs, most of which were in the technology sector.

More specifically, at the end of March 2000, of the approximately \$70,000 in AG's individual account—which represented virtually her entire liquid net worth—over 81% was invested in UITs, and the concentration remained in that range through June 2001. As for her IRA, it held approximately \$35,000 in assets, and anywhere from 77% to 100% of those assets were UITs during the period April 2000 through July 2001. In both of AG's accounts, the vast majority of the UITs purchased were in the pharmaceutical or technology sector. See Enf. Ex. 48. To make matters worse, at one point—in the spring of 2001—when UITs represented approximately 81% of the IRA account's holdings, another 18% was comprised of stock in a technology company. Tr. at 452. Adding to the overall risk was the use of margin in AG's individual account, which she testified she did not know about or understand at the time. See Enf. Ex. 87 at 18.

As a general rule, a young person can usually afford to have some money invested in high-risk securities. AG, who was in her mid 30's, was younger than any of the other customers at issue in this case and, unlike many of them, was gainfully employed at all times. Thus, it may have been appropriate to invest some of her cash into technology-sector securities. However, Respondent simply went too far. His trading was unsuitable for AG because: (1) the high-risk UITs into which he placed her represented the vast majority of her net worth; (2) her net worth was relatively modest to begin with; (3) a significant portion of her investments were made on margin; and (4) she did not possess any understanding of the risk that her investments entailed.

Customer EW

Customer EW was introduced to Respondent by a mutual friend—and erstwhile customer of Respondent—SK. When he opened his account with Respondent in April 2000, EW was a 78-year old retiree with a high-school education and absolutely no experience investing in securities. In fact, EW was explicitly relying on his friend's advice and oversight, as well as Respondent's recommendations, when it came to investing, and Respondent was aware of that. Nevertheless, without having SK vet the investments as agreed, Respondent shifted almost all of EW's cash deposit of just under \$115,000—approximately 65% of EW's net worth—into UITs as soon as the account was opened. From that point through the end of September 2001, UITs accounted for anywhere from 84% of the account value to over 100%, due to the use of margin. Enf. Exs. 20, 51. Although the UITs being held in the account changed over time, at any given time, most of the UITs were from the energy, technology, and pharmaceutical sectors. EW testified that he had no idea what a UIT was, nor did he understand what a margin account consisted of. Enf. Ex. 92 at 10.

The Panel finds that it was clearly unsuitable for Respondent to put such a large percentage of EW's net worth into such high-risk investments, especially given the customer's advanced age and overall vulnerability due to his lack of financial acumen. The use of margin in EW's account only exacerbated the unsuitability of the investments.

Other Customers

Enforcement submitted documentary evidence regarding several other customers, including account statements and other financial documents, as well as written analysis and expert testimony regarding those documents. This evidence established that Respondent was purchasing the same technology and pharmaceutical UITs in account after account, over the same time frame, for all of the customers at issue in this case, including elderly retirees, often investing almost all of the individual's net worth in such UITs. See, e.g., Enf. Exs. 19, 22, 26, 27, 28, 29, 32, 33.

It is obvious that Respondent was employing a risky, one-size-fits-all investment strategy for all of these customers, which caused the same result for all of them—an overconcentration in UITs, especially technology-sector UITs, without regard to the individual customer's age, employment status, net worth, financial objectives, or other relevant circumstances. As Enforcement's expert put it:

I think what's important to recognize [is that] there's an overall pattern in these accounts. So it's highly unlikely that 15 customers came in and said, you know what, damn the torpedoes, I want to be in aggressive equity. That stretches the imagination a bit. And I'm suggesting [that]...to have all 15 people move in the same direction at the same time for the same reason because it's damn the torpedoes, I want to expose my life savings to a market condition or a strategy, [is] not believable for me.

Tr. at 526.

Worse yet, Respondent seemed to have had no hedging strategy, since he did nothing to mitigate the losses in his customers' accounts—losses that grew larger and larger, month after month. As Enforcement's expert put it:

I think there is a pattern [in the account statements] that is wedded to the idea of technology concentration, which [is] for reasons beyond my ability to understand on the face of the statements alone. And I think that there's also a somewhat dangerous approach to applying the strategy to these clients, in that there was no plan to resolve or exit from the strategy when it didn't go well.

Id. at 493.

In the Panel's view, the overemphasis on technology UITs in the various non-testifying customers' accounts, combined with the use of margin in several cases, constituted unsuitable trading on behalf of these customers. As observed by a hearing panel in a matter involving a similarly short-sighted trading approach that caused significant losses in customers' accounts:

While there is no “perfect” portfolio for any particular customer, Respondent did not take even ordinary steps to protect his customers’ interests and achieve their stated goals. He did not diversify their investments for their multiple objectives of preserving principal and achieving growth. He did not invest in certificates of deposit, mutual funds, bonds, or other forms of investment. He did not diversify the sectors in which he bought stock or invest in fixed income stocks that would generate appreciable dividends.... The unsuitability of Respondent’s actions is not evident in any one trade or his position in any one stock; rather it is manifest in the overall structure and strategy of his customers’ portfolios. Respondent compounded the unsuitability of the investments he made on behalf of his customers by having no strategy to withstand unfavorable market conditions.

Plase Michael Tansil, Decision 06-43, at 15 (NYSE Hearing Board Sept. 18, 2006). We believe the same holds true in this case.

In light of the above, the Hearing Panel found Respondent guilty of Charge I.

Charge II: Unauthorized Trading in the LP Account

The Panel found that the evidence supporting Charge II was tenuous at best. Enforcement alleged that Respondent executed three separate transactions on June 28, 2001 without the prior authorization of his customer LP. Enforcement relied on purported admissions by Respondent in his prior on-the-record testimony and in correspondence with his former manager, as well as on-the-record testimony by Respondent’s former manager.

However, there was contradictory evidence on this issue. During his on-the-record testimony, the supervisor relayed a conversation he had had with the customer, which occurred when the supervisor called the customer about three trades that took place on June 28, 2001. See Enf. Ex. 96 at 34. In the supervisor’s words:

[LP’s] first response was, I don’t know what you are talking about. Then as we discussed it, he remembered talking to [Respondent] previously about something but I really felt that it was an instance where, you know, [Respondent] wasn’t clear enough about the transactions that he wanted to do with [LP]

Id.

The supervisor did not testify that the customer had categorically denied giving authorization for the transactions in question. Moreover, at the hearing, Respondent denied that the trades had been unauthorized; he testified that, while he was traveling in South America, he had in fact had a conversation with LP about the transactions prior to executing them. See Tr. at 995-97. More specifically, Respondent testified that one of the trades was a sale of a mutual fund that was

poised for a major drop because of Argentina's decision to default on a loan from the International Monetary Fund around that time. Respondent stated that he had previously explained this contingency to LP and, therefore, they had an "understanding" that, should the contingency materialize, Respondent would sell the fund. Id. at 996-97. The other two trades involved the purchase of UITs that Respondent had previously purchased on behalf of LP. These trades were consistent with past trades in the account, and it is conceivable that Respondent had discussed them with LP. Such a finding is supported by certain contemporaneous notes that Respondent's former manager kept regarding a telephone conversation that he had with LP, in which he wrote:

[LP] tells [Respondent] do what you think is right and [Respondent] keeps him updated once in a while. At the end of the conversation, he was wavering as to [whether] Luis t[old] him about the trades or not, but he maintained that he didn't remember them at all.

Enf. Ex. 106B.

Taking all of the evidence together and using the applicable preponderance of the evidence standard, the Panel finds that Enforcement has not met its burden of proving that the three trades were indeed unauthorized.⁵ Accordingly, the Hearing Panel found Respondent not guilty of Charge II.

PENALTY

In determining the appropriate penalty, the Panel was required to consider a number of factors, including the seriousness of the offense, the corresponding harm to the trading public, the potential gain to Respondent from his violation, the potential for repetition in light of the current regulatory and enforcement regime, and the deterrent value to Respondent and others. McCarthy v. SEC, 406 F.3d 179, 190 (2d Cir. 2005). Other important factors that are routinely used to guide the determination of penalty include the degree of scienter and the degree to which Respondent has taken responsibility and feels remorse for his actions. See Factors Considered By The New York Stock Exchange Division Of Enforcement In Determining Sanctions, Information Memo. 05-77 (Oct. 7, 2005), at 2-3.

Enforcement recommended a penalty of a five-year bar and restitution in the amount of \$195,000. In support of its penalty, Enforcement argued that the five-year bar was necessary to protect customers from future harm, since heightened supervision would not be enough. Enforcement cited, among other cases, the matter of Plase Michael Tansil, Decision 06-43 (NYSE Hearing Board Sept. 18, 2006), in which a hearing panel imposed a penalty of a five-year bar on a broker who, like Respondent, caused hundreds of thousands of dollars in losses for

⁵ It is unclear whether Respondent had obtained proper prior written authorization from LP to engage in the type of discretionary trading that appears to have occurred in LP's account. Nevertheless, since Respondent was not charged with having violated a discretionary trading rule, such as NYSE Rule 408(a), we limit our decision to a finding that that he did not execute unauthorized trades in violation of NYSE Rule 476(a)(6).

several customers by using a one-size-fits-all trading approach that was completely unsuitable for them. See Tansil, Decision 06-43, at 13-16 (covered call trading strategy involving volatile technology stocks found unsuitable where used for all customers, regardless of net worth, employment status, age, and stated investment objectives, among other factors). Enforcement further argued that \$195,000 in restitution was warranted to cover the losses sustained by three customers, EW, YG, and DA, who, at the time of the hearing, had not received any compensation, be it through an arbitration award, a settlement, or otherwise. Enforcement cited two cases to support the imposition of a restitution payment by Respondent—an NYSE decision in a stipulated matter, and an NASD decision in a contested one. See David A. Noyes & Co., Inc., Decision 05-98 (NYSE Hearing Board Nov. 9, 2005) (consent to pay restitution of up to \$375,000 to customers who had been harmed by firm's unsuitable annuity switches); Dep't of Enforcement v. Mazzei, Case No. C10970120 (NASD OHO June 24, 1998) (ordering restitution of about \$42,000 for unsuitable recommendations).

Respondent argued against a penalty of restitution on several grounds. First, EW had already settled his claim against Respondent by the time the hearing was concluded. Second, according to Respondent, the Firm probably had good reason for not paying the other two customers who had yet to receive any compensation. Third, he argued that arbitration was a more fair and thorough process for compensating customers for their losses.

The Panel agrees that ordering restitution in this case would not be appropriate. First, the Panel was not persuaded that the amount of the losses, as alleged by Enforcement, is reliable. No specific evidence—documentary, expert, or otherwise—was submitted to directly substantiate the figures that Enforcement referred to in its closing argument, other than account statements. Moreover, the Noyes matter is obviously distinguishable in that it involved a stipulation by the respondent firm; but more importantly, the decision established an elaborate procedure through which the firm was required to hire an independent expert to analyze customer claims and determine the precise amount of restitution to be paid to any particular customer. See Noyes, Decision 05-98, at 8-10. As a general matter, we believe that the arbitration process is a more appropriate method for assessing losses and deciding on whether to award restitution or other compensation. We, therefore, decline to order any restitution in this case.

However, we believe that a lengthy bar must be imposed here to protect the investing public and deter Respondent from repeating his egregious and highly damaging conduct.

There is precedent for imposing a permanent bar in cases involving unsuitable transactions that were accompanied by other violations, such as unauthorized trading. See, e.g., William Floyd Gibbs, Sr., Decision 06-41 (NYSE Hearing Board Mar. 27, 2006) (consenting to permanent bar for unsuitable trades in 144 accounts and exercising discretion without prior written authorization); Grant Ross, Decision 94-177 (NYSE Hearing Board Dec. 22, 1994) (permanent bar imposed by default in light of uncontested allegations of unsuitable and unauthorized trading, misstatements to customers and firm, and violations of NYSE Rules on options). Since we have found Respondent guilty of only one charge—unsuitable trading—we believe that a permanent bar would be excessive.

On the other hand, we believe that the five-year bar imposed in Tansil would not be a sufficient penalty in the instant matter. First, the harm caused by Respondent's unsuitable trading affected 20 customers—almost three times as many as those harmed by Tansil, who caused losses in the account of seven customers. Moreover, in many instances in this case, all or almost all of a customer's liquid net worth—which was, in most cases, modest to begin with—was wiped out. In several cases, customers of advanced ages and limited means who had retired were forced to return to work in order to cover basic living expenses. Second, and perhaps more significantly, unlike Tansil, Respondent demonstrated actual bad faith in this case.

Respondent's bad faith took at least three forms. To begin with, the evidence showed that Respondent engaged in collusive behavior with one of his customers, JJ, perhaps in an attempt to deflect attention and, thus, retribution away from himself. In secretly-made tape recordings of conversations between Respondent and customer JJ that were admitted in evidence, Respondent is heard conceding that his trading was unsuitable for JJ and encouraging the latter to file an arbitration claim against the Firm. See Enf. Exs. 73, 75-77. Respondent apparently believed that he could make the entire problem go away by persuading his customer JJ that they were on the same side and encouraging JJ to obtain money from the firm. This was highly unethical.

Respondent also demonstrated bad faith in his attempts to hide an oral complaint made by SK on behalf of his friend EW. SK testified that he called the Firm to complain about what had occurred in EW's account and that Respondent later called SK back and told him, "Don't do that again. If you want to contact anybody, contact me. Don't contact the office." Enf. Ex. 91 at 17. SK could tell that Respondent was angry, and, after that incident, SK never again contacted anyone at the Firm other than Respondent. Id. at 18. Respondent was undoubtedly attempting to hide the existence of a customer complaint. Such conduct is highly improper and dangerous because it has the potential to undermine the entire regulatory framework.

Finally, testimony from CD established that Respondent had attempted to coerce CD into providing testimony that might be favorable to Respondent at the penalty phase of this hearing. CD testified that, on the day immediately following the first three days of hearings in this matter, Respondent called her and attempted to pressure her into signing an affidavit to the effect that she had "overstated" her claims in the arbitration that she had pursued against the Firm. Tr. at 869. When she refused, he made a veiled threat to expose alleged "funny" conduct by her in connection with her small business. Id. at 870. CD understood this as an attempt to further pressure her into signing an exculpatory affidavit. She testified as follows:

He [Respondent] called me probably a couple weeks ago. It was the day after you had your three days of hearing. It was Friday morning, about 8:30 in the morning and I picked up the phone and it was him. ... [H]e said I've just been through three days of hearings. And he said and I want to tell you, I know you didn't testify and I appreciate that, we've always been friends, he said, I've always liked you. And I said well, I just chose not to, I just wanted to put this behind me, Luis. And then he said well, he said they're after my license and he said they're going to get it, whether it's six months, a couple years, forever, I don't know. But he said

what I need you to do for me is sign an affidavit that you overstated your claims against me in that lawsuit. And I said I can't do that because number one, that's what happened, and number two is if A.G. Edwards settled, where would that leave everything? He said that wouldn't matter; they paid you, that's done, that couldn't come up again. And I said well, [r]egardless of that, I can't recant that, because it was the truth. And he said well, sign an affidavit that your attorney over, blew it up. I said that didn't happen either. I said he went from my chronology. Everything that he filed was what I had told him. So I can't do that. And then Luis said well, if I'm going down, I have a family to feed, I'm taking everyone with me and there was funny stuff with [CD's small business]. He never mentioned my severance pay, but he said there was funny stuff. And to me, I took it as a threat. I called my attorney right away....

Tr. at 869-70.

Respondent appears to have been aware that the losses he caused would be a factor in determining the severity of his penalty. Not only did he fail to take responsibility for his misconduct, he actually attempted—in a shocking, abusive, and highly unethical manner—to fabricate a mitigating circumstance. Such conduct is completely unacceptable for a registered representative and must be severely punished.

In view of the above findings, the Hearing Panel imposed the penalty of a censure and a ten-year bar from membership, allied membership, approved person status, and from employment or association in any capacity with any member or member organization.

For the Hearing Board

Vincent F. Murphy - Hearing Officer
Panelists:
- Steven Jackson
- James C. Walshe