

**NASD
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

COMPLAINANT,

v.

KEVIN GUZMAN (CRD No. 4497415),

RESPONDENT,

AND

RESPONDENT.

**DISCIPLINARY PROCEEDING
No. 20050000720-02**

HEARING OFFICER —

COMPLAINT

The Department of Enforcement alleges:

JURISDICTION

Kevin Guzman

1. On or around February 6, 2002, Kevin Guzman first became registered with NASD as a General Securities Representative through an association with a member firm.
2. Guzman's registration through that firm ended on or around November 20, 2002 when that firm mass transferred its brokers to Ladenburg, Thalmann & Co., Inc. (BD No. 505).
3. Subsequently, Guzman was registered through an association with member firm Joseph Stevens & Co. Inc. (BD No. 35459) as a GSR (from or around August 29, 2003 through or around December 17, 2004) and as a General Securities Principal (from or around June 18, 2004 through or around December 17, 2004).

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4. On or around December 17, 2004, Joseph Stevens filed a Uniform Termination Notice for Securities Industry Registration (Form U-5). The Form U-5 indicated that Guzman's termination was voluntary.
5. The Form U-5 also stated that Joseph Stevens had received a verbal complaint against Guzman from customer CSR.
6. After his employment with Joseph Stevens ended, Guzman was registered as a GSR (beginning on or around August 8, 2005) and GSP (beginning on or around November 17, 2005) through an association with another member firm. That association ended on or around September 6, 2006. The member firm included a termination comment on a Form U-5 regarding Guzman that stated: "RR absent without notice or explanation to the Firm. RR failed to report receipt of a Wells Letter on Form U-4."
7. Guzman is not currently registered with NASD. Pursuant to Article V, Sec. 4 of the NASD By-laws, Guzman remains subject to the jurisdiction of NASD.

[REDACTED]

8. Since in or around November 1992, [REDACTED] has been registered with NASD through consecutive associations with several different member firms.
9. On or around November 15, 1992, [REDACTED] first became registered with NASD as a GSR through an association with a member firm.
10. On or around July 1, 1997, he first became registered with NASD as a GSP through an association with a different member firm.
11. From on or around September 26, 2002 through the present, [REDACTED] has been registered as, *inter alia*, a GSR and GSP through an association with member firm Joseph Stevens.

██████████ therefore remains subject to the jurisdiction of NASD pursuant to Article V, Section 4 of NASD's By-Laws.

BACKGROUND

12. Paragraphs 1 through 11 of the Complaint are re-alleged and incorporated herein by reference.

Customers CSR and SG

13. CSR and SG are married to each other and live in Puerto Rico.
14. CSR is retired and is approximately 63 years old. He worked as a production supervisor for ██████████ a manufacturer of household beauty and health products, for over 23 years. He retired from that job in or around 1999. He has a high school education. He has no training in finance. He had not made any investments prior to investing with Guzman, except for mutual funds that he held for three years and that he did not trade after purchasing.
15. SG is in her 50s. She is Guzman's aunt. In the past, she worked as a machine operator. She left work approximately seven years ago to care for her elderly mother.
16. By in or around 2003, CSR and SG had accumulated savings of over \$300,000.

The Ladenburg Joint Account

17. In or around January 2003, Guzman met with CSR and SG in Puerto Rico, and Guzman convinced CSR and SG to invest with him.
18. At that time, CSR told Guzman that the money they were investing with him represented their life savings; that they needed the money for their retirement; and that it should be invested safely and conservatively. Guzman assured them that he would not invest in

anything risky; that he understood CSR and SG's needs to preserve the funds; and that he would watch over their account and make sure they never suffer any sizeable losses.

19. In or around February 2003, Guzman opened a joint account for CSR and SG at Ladenburg.
20. CSR and SG's net worth at that time was under \$500,000, and consisted of their savings (approximately \$300,000), their home (approximately \$150,000), home furnishings (approximately \$8,000) and an automobile (approximately \$7,000). Their joint income for the year 2002 was under \$60,000 and was generated from the job that CSR then held.
21. CSR and SG deposited their entire savings of approximately \$300,000 into the Ladenburg joint account that Guzman opened for them.
22. Although the new account documents for the Ladenburg joint account indicated that the investment objective was speculation, Guzman invested the entire \$300,000 in Class A mutual funds.
23. Guzman agreed to send CSR and SG approximately \$3,000 per month from the Ladenburg joint account as a supplement for CSR's social security benefits, which were due to begin shortly thereafter. From May through August 2003, approximately \$11,000 in disbursements were paid to CSR and SG from the Ladenburg joint account.
24. When Guzman left Ladenburg to join Joseph Stevens, he asked CSR and SG to transfer their Ladenburg joint account to his new firm. They agreed.

The Joseph Stevens Joint Account (the "Account")

25. In or around September 2003, CSR and SG signed a new account application for the Account. Their net worth at that time remained approximately what it had been in February 2003 – it remained under \$500,000, and consisted of their savings

(approximately \$300,000), their home (approximately \$150,000), home furnishings (approximately \$5,000) and an automobile (approximately \$7,000). Their investment objectives also remained the same - the money they invested at Joseph Stevens represented their life savings, they needed the money for their retirement, and they wanted it to be invested safely and conservatively.

26. In or around October 2003, the mutual funds CSR and SG had purchased at Ladenburg were transferred to the Account. At the end of October 2003, the market value of the Account was approximately \$331,682.09.
27. In or around October 2003, Guzman sold all of the mutual funds transferred from Ladenburg. He invested 100% of the proceeds in common stock of and options for a single technology company. In November and December of 2003, Guzman added to the Account's activity margin purchases and sales of a single pharmaceutical company. By the end of January 2004, Guzman sold all of the Account's stock of the original technology company it had held. For the rest of the life of the Account, Guzman invested the Account's assets on a rotating basis in a few technology and pharmaceutical companies, and most of the time, 100% of the Account's assets were held in one, two or three stocks.
28. CSR and SG continued to receive approximately \$3,000 a month from the Account through October 2004, except in October and December 2003 when they received a disbursement of approximately \$10,000.
29. When the Account was closed in November 2004, its value was approximately \$2,200.

Supervision of Guzman

30. During part of Guzman's association with Joseph Stevens, [REDACTED] supervised Guzman. Specifically, from at least September 2003 through January 2004, [REDACTED] supervised Guzman. During that time, [REDACTED] ignored red flags warning of Guzman's misconduct.
31. In or around February 2004 through July 2004, [REDACTED] joined Guzman in a partnership (the Partnership). The Partnership serviced Guzman's accounts, including the Account. Guzman and [REDACTED] split 50/50 their share of commissions on accounts serviced by the Partnership.
32. After [REDACTED] entered the Partnership with Guzman, he ceased acting as Guzman's supervisor and a new supervisor was assigned to supervise Guzman.

FIRST CAUSE OF ACTION

Against Guzman

(Churning, Excessive Trading and Unsuitability)

Violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Conduct Rules 2120, 2310 and 2110 and IM-2310-2(b)(2)

33. Paragraphs 1 through 32 of the Complaint are re-alleged and incorporated herein by reference.
34. From October 2003 through November 2004, trading activity in the Account was unsuitable and excessive in size and frequency in view of CSR and SG's financial situation and needs, i.e., CSR was about to retire, SG had not worked in 7 years, the money represented their life savings, and they wanted the money invested safely and conservatively.
35. During that timeframe, CSR and SG lost approximately \$280,000 of their initial investment with Joseph Stevens of approximately \$330,000. During that same

timeframe. CSR and SG received disbursements of \$55,109 and the Account was charged commissions, mark-ups and mark-downs of \$182,996.

36. From October 2003 through November 2004, CSR and SG received in the mail monthly account statements describing the Account's activity. They did not understand the information in the statements and could not discern whether the Account was generating a profit or a loss. Neither CSR nor SG had a financial background, and prior to investing with Guzman, their only investment experience consisted of investments in a few mutual funds that they did not trade after purchasing.
37. From October 2003 through November 2004, Guzman directed all of the transactions in the Account. During that time period, Guzman telephoned CSR and SG at their home in Puerto Rico from his office in New York. CSR and SG accepted all or virtually all of Guzman's recommendations for transactions. Guzman therefore exercised *de facto* control over the Account.
38. Although the Account was assigned to the Partnership between Guzman and [REDACTED] for the period February through July 2004, Guzman directed all of the transactions in the Account during the time of the Partnership.
39. From October 2003 through November 2004:
 - a. Guzman directed over 100 transactions in the Account. Purchases totaled approximately \$2,534,195.00, using average monthly account equity of approximately \$106,445.40.
 - b. The costs of trading incurred by the Account were at least \$187,394.00.

- c. The Account's cost-to-equity ratio was at least 176.05%. On an annualized basis, the cost-to-equity ratio was at least 150.90%. Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 176% to break even on the investments, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 150% to break even.
- d. The turnover ratio was at least 23.807, indicating that the securities in the Account were replaced by new securities at least 23 times. On an annualized basis, the turnover ratio was at least 20.41, with the securities in the Account having been replaced by new securities at least 20 times annually.
- e. The Account was charged \$182,996 in commissions, mark-ups and mark-downs, which represented approximately 55% of CSR and SG's initial investment with Joseph Stevens. The commissions-to-equity ratio was at least 171.92%. The annualized commissions-to-equity ratio was at least 147.36%. Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 171% to recover for commission costs alone, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 147% to recover for commission costs alone.
- f. Guzman executed frequent short-term, or "in and out," buying and selling of the same securities in the Account, the commissions and markups for which generally exceeded the profits generated. For example:
 - i. During October 2003, Guzman initiated an options covered writing program on Intel. During the next three months (Oct. 2003 to Dec. 2003), Guzman generated commissions of approximately \$53,000 on the

purchases and sales of Intel common shares and approximately \$10,000 on the purchases and sales of Intel options. The Account realized a net loss of approximately \$50,000 on the activity due to those transactions.

- ii. On November 14 and 26, 2003, Guzman bought approximately 25,000 shares of Antigenics. He sold all of those shares between November 28, 2003 and February 13, 2004 for a loss of approximately \$20,833. The markups and markdowns generated on those Antigenics purchases and sales totaled approximately \$43,700.
- iii. On January 26, 2004, Guzman bought approximately 5,000 shares of American Pharm. He sold all of those shares approximately four days later. The Account realized a loss from those transactions of approximately \$32,024 of which approximately \$12,500 was markups and markdowns.
- iv. On March 3, 2004, Guzman bought approximately 10,000 shares of Comtech. He sold all of those shares approximately eleven days later. The Account realized a loss from those transactions of approximately \$22,473, of which approximately \$20,000 was markups and markdowns.
- g. Guzman directed the transactions without reasonable grounds for believing that the level of activity represented by such transactions was suitable based on CSR and SG's financial situation and needs.
- h. Guzman's pattern and level of trading activity in the Account during this period, considered in light of CSR and SG's financial situation and needs, demonstrated Guzman's purpose to derive a profit for himself at the expense of CSR and SG.

40. Even before the Partnership, i.e., between October 2003 and the end of January 2004, Guzman churned and excessively traded the Account.
41. By virtue of this conduct, Guzman, by the use of any means or instrumentality of interstate commerce or of the mails, intentionally or recklessly engaged in manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities, and intentionally or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive or other fraudulent devices or contrivances.

By reason of the foregoing, Guzman violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, NASD Conduct Rules 2110, 2120 and 2310(a), and IM-2310-2(b)(2).

SECOND CAUSE OF ACTION
Against Guzman
(Inaccurate New Account Documents)
Violation of NASD Conduct Rules 3110(a) and 2110.

42. Paragraphs 1 through 41 of the Complaint are re-alleged and incorporated herein by reference.
43. Guzman oversaw the creation of and signed the new account and other applications for the Account. Guzman knew or should have known that those documents contained inaccurate and misleading information about CSR and SG's financial profile and needs.
44. On or about January and March 2003, Guzman prepared or caused to be prepared new account applications for CSR and SG's joint account at Ladenburg. He oversaw the creation of such applications for six Ladenburg accounts. Only two of those accounts actually were opened and held assets, and one was closed after transferring a few assets

to the other account. Those applications indicated that CSR and SG's income was \$100k, their liquid net worth was \$500k, and their net worth was \$1 million. Those applications also indicated that CSR had 10 years of investment experience.

45. Guzman also prepared or caused to be prepared, completed portions of the following documents for the Account:
- a. A new account application dated September 2, 2003 (the Initial Application).
 - b. An account update application dated October 20, 2003 (the Update Application).
 - c. An application for the opening of aau option account dated October 20, 2003 (the Option Application).

He then sent the completed documents to CSR and SG and instructed them to sign the documents. After CSR and SG returned signed copies, Guzman signed the documents as account executive.

46. The Initial Application contained income, net worth and investment experience information substantially different from and inconsistent with the same kind of information contained in the Ladenburg applications, the Update Application and the

Option Application. The information differed as follows:

<u>Document</u>	<u>Dated</u>	<u>Income</u>	<u>Liquid Net Worth</u>	<u>Net Worth</u>	<u>Investment Experience.</u>
Ladenburg Application	January and March 2003	\$100k	\$500k	\$1 million	10 Years
Initial Application	September 2, 2003	\$60k	\$1.5 million	\$600k	6 Years
Update Application	October 20, 2003	\$200k	\$600k	\$1.5 million	20 Years
Option Application	October 20, 2003	\$200k	\$600k	\$1.5 million	20 Years in Options/Stocks/Bonds

47. Except for the \$60k income recorded on the Initial Application, the financial information and investment experience recorded on the Initial Application, the Update Application and the Option Application were inaccurate and extremely overstated.
48. The inaccurate level of income inappropriately qualified the Account under Joseph Stevens's Option Procedure Memo to trade options. That Memo required an investor to earn \$100,000 a year in income to trade options.
49. Guzman included that false financial information and investment experience, or caused that information to be included, on the Initial Application, the Update Application and the Option Application.

By reason of the foregoing, Guzman violated NASD Conduct Rules 3110(a) and 2110.

THIRD CAUSE OF ACTION
Against Guzman
(Misrepresentations to Customer)
Violation of NASD Conduct Rule 2110

50. Paragraphs 1 through 49 of the Complaint are re-alleged and incorporated herein by reference.

51. In connection with queries by CSR regarding the Account, Guzman made the following false statements to CSR:
- a. In or about mid-2004, Guzman misrepresented to CSR and SG, during a dinner in New York City, that because the market was not doing well, he had stopped placing trades for the Account. However, during that time period, Guzman continued to actively trade the Account.
 - b. At the same dinner in New York City in or about mid-2004, Guzman also misrepresented that the Account was then worth in the high \$200,000 range. At all times during mid-2004, the Account's value was far lower than \$200,000.
 - c. On or about October 20, 2004, Guzman, at CSR's request, agreed to send CSR \$10,000 from the Account. CSR wanted the money to fund a trip to Mexico. Guzman repeatedly assured CSR that CSR would receive a check for \$10,000, but CSR never received it.
 - d. On or about November 2004 (on the day before CSR's trip to Mexico), CSR inquired about the value of the Account. Guzman misrepresented to CSR that the Account was worth \$270,000. The Account was worth less than \$7,500 at month end September 2004, and its value only decreased thereafter.
 - e. On or about November 2004, Banco Bilbao in Puerto Rico, at CSR's direction, requested the transfer of the Account's balance to Banco Bilbao. After a Banco Bilbao representative informed CSR that the bank had received the Account's balance of approximately \$2,200, CSR immediately contacted Guzman. Guzman informed CSR that the \$2,200 was from a small account that held the cash for the

monthly payments and that \$270,000 was held in another account Guzman had opened to avoid risking loss in an unstable market. Guzman told CSR to have Banco Bilbao resubmit the transfer forms. After Banco Bilbao made a second request and confirmed the balance of approximately \$2,200, Guzman informed CSR that the bank was not handling the transfer properly and that Guzman would send the money to CSR. When CSR did not receive the check, he contacted Guzman who told CSR that the check was returned because it was delivered to the wrong address; that the check would be sent by Federal Express; and that CSR would have the check by Thanksgiving Day. CSR never received the check.

- f. In or about December 2004, CSR contacted Joseph Stevens. Joseph Stevens informed CSR that Guzman no longer worked there. It provided CSR with the name of Guzman's new employer. When CSR contacted Guzman at his new firm, Guzman told CSR that CSR's money was safe when Guzman knew that was false and that CSR had to contact Joseph Stevens to find out what happened to his money because the firm "screwed-up."

By reason of the foregoing, Guzman violated NASD Conduct Rule 2110.

FOURTH CAUSE OF ACTION

Against [REDACTED]

(Failure to Supervise)

Violation of NASD Conduct Rule 3010 and 2110

52. Paragraphs 1 through 51 are re-alleged and incorporated herein by reference.

Failure to Supervise Guzman's Churning, and Excessive and Unsuitable Trading

53. From October 2003 through January 2004, Guzman was the sole broker responsible for the Account, and [REDACTED] was his supervisor.

54. During that timeframe, Guzman directed all of the transactions in the Account, and CSR and SG accepted all or virtually all of Guzman's recommendations for transactions.
55. During that timeframe, Guzman's trading activity in the Account was unsuitable and excessive in size and frequency in view of CSR and SG's financial situation and needs.

During that period:

- a. Guzman directed over 70 transactions in the Account. Purchases totaled approximately \$1,855,992.00, using average monthly account equity of approximately \$292,780.00.
- b. The costs of trading incurred by the Account were at least \$119,827.00.
- c. The Account's cost-to-equity ratio was at least 40.93%. On an annualized basis, the cost-to-equity ratio was at least 122.78%. Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 40% to break even on the investments, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 122% to break even.
- d. The turnover ratio was at least 6.339, indicating that the securities in the Account were replaced by new securities at least 6 times. On an annualized basis, the turnover ratio was at least 19.02, with the securities in the Account having been replaced by new securities at least 19 times annually.
- e. The Account was charged approximately \$118,329 in commissions, mark-ups and mark-downs, which represented approximately 36% of CSR and SG's initial investment with Joseph Stevens. The commissions-to-equity ratio was at least 40.42%. The annualized commission-to-equity ratio was at least 121.25%.

Accordingly, it would have been necessary for CSR and SG to earn a rate of return of at least 40% to recover for commission costs alone, and, on an annualized basis, CSR and SG would have needed a rate of return of at least 121% to recover for commission costs alone.

- f. Guzman executed frequent short-term, or "in and out," buying and selling of the same securities, the commissions and markups for which generally exceeded the profits generated, as described in paragraph 39(f) above.
 - g. Guzman executed the transactions, or caused the transactions to be executed, without reasonable grounds for believing that the level of activity represented by such transactions was suitable based on CSR and SG's financial situation and needs.
 - h. Guzman's pattern and level of trading activity in the Account during this period, considered in light of CSR and SG's financial situation and needs, demonstrated Guzman's purpose to derive a profit for himself at the expense of CSR and SG.
56. From October 2003 through January 2004, [REDACTED] reviewed Daily Transaction Reports, New Account Documents and Suitability Supplements for the group of salespeople assigned to him, which included Guzman.
57. [REDACTED] signed GSP reports, which were monthly documents whereon Joseph Stevens GSPs confirmed that they had reviewed Daily Transaction Reports, New Account Documents and Suitability Supplements for the group of salespeople assigned to them. [REDACTED] signed such reports stating that he had conducted such reviews for the months of at least October through December 2003.

58. The Daily Transaction Reports contained "red flags" that should have alerted [REDACTED] that Guzman was churning and unsuitably trading in the Account. From those reports, [REDACTED] should have noticed an unsuitable level of trading and commission and mark-up/mark-down charges. For example, in the first two months of the Account's existence, Guzman made approximately 53 trades. Over the first three months of the Account's existence, Guzman made approximately 66 trades. In the first four months of trading, the Account was charged approximately \$118,329 in commissions, mark-ups and mark-downs, which was equal to approximately 35% of the Account's initial value.
59. That level of activity and commissions should have caused [REDACTED] to take affirmative steps to investigate the activity in the Account. [REDACTED] supervisory response to the level of activity and commissions was inadequate. He did not call the customer to discuss the activity in the Account. He did not discuss the Account's trading strategy with Guzman or question Guzman about the Account's activity. Although the Joseph Stevens compliance department sent CSR and SG a letter in December 2004 inviting them to contact Joseph Stevens for assistance, information on other investment opportunities or if they encountered any problems with Joseph Stevens's servicing of their account, that letter did not satisfy [REDACTED] supervisory responsibilities.

*Failure to Supervise Guzman's Creation of
New Account Documents and Updates for the Account*

60. During September and October 2003, [REDACTED] signed the Update Application and the Option Application as a Joseph Stevens principal and Guzman's supervisor. He lacked reasonable grounds to approve either document.

61. Those documents contained significantly different financial and investment experience information than the Initial Application, which [REDACTED] also signed just six weeks before signing the Update Application and the Option Application.
62. [REDACTED] made no attempt to question or verify the differences among the documents in income from \$60k to \$200k or the differences in the investment experience from 6 years to 20 years. Despite the inconsistencies among the documents, [REDACTED] verification of the information contained therein consisted solely of questioning Guzman.
63. The differing information among the documents constituted a "red flag." In response to that "red flag," [REDACTED] should have taken affirmative steps to investigate and verify the information in the Update Application and Options Application through a source other than Guzman. He did not do so.
64. [REDACTED] lack of supervision likely had serious consequences for the Account. The financial picture of CSR and SG and the investment objective of "Speculation" indicated by the Account Update and the Option Application likely reduced oversight over the Account by those who supervised Guzman from February 2004 through November 2004, which was the period after [REDACTED] supervisory responsibilities over Guzman ended. Further, the inaccurate information qualified the Account to trade options when CSR and SG's truthful financial profile likely would not have.

By reason of the foregoing, [REDACTED] violated NASD Conduct Rules 3010 and 2110.

PRAYER FOR RELIEF

WHEREFORE, Complainant respectfully requests that the Panel:

- A. order that one or more of the sanctions provided under NASD Rule 8310(a) be imposed, including that Guzman be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;
- B. order that Guzman and [REDACTED] bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with NASD Rule 8330.

NASD DEPARTMENT OF ENFORCEMENT

Date: December 4, 2006



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