

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

William Bailey (CRD No. 1085215),

Respondent.

DISCIPLINARY PROCEEDING
No. 2006007058102

HEARING OFFICER:

COMPLAINT

The Department of Enforcement alleges:

OVERVIEW

1. Between January 1, 2006 and December 31, 2007, Respondent William Bailey, a Mesa, Arizona-based registered representative at Next Financial Group, Inc., made fraudulent and unsuitable mutual fund and variable annuity switch recommendations to seven retired and unsophisticated customers. Respondent also executed transactions on a discretionary basis in his clients' accounts without receiving prior written trading authority and was responsible for mutual fund switch forms on which he, or his staff with his knowledge, regularly predated the client signature line prior to mailing them to the clients for signature, and added information after the forms were signed in order to make it appear that his clients were aware of certain fees before the trades were executed.

2. Respondent engaged in a pattern of short-term trading and switching of mutual funds in seven accounts belonging to seven of his customers.¹ In each of the accounts Respondent, on behalf of his customers, repeatedly sold mutual funds less than one year after purchasing them and purchased new mutual funds ("short-term trading" or "short-term transactions") with the proceeds. To advance his short-term trading strategy, Respondent engaged in discretionary trading without prior written authorization, misled customers about the trades, and falsified mutual fund switch forms, by predating signature lines and adding disclosures after they had been signed and returned by customers. Due to the size and frequency of the resulting trades and also because Respondent omitted material information concerning fees and other expenses related to the transactions, his conduct violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder and NASD Rules 2120 and 2110.

3. The pattern of short-term trading and switching of mutual funds was also unsuitable under NASD Rules 2310, IM-2310-2(b)(3) and 2110 in light of the frequency of the mutual fund transactions and the objectives and financial situations of Respondent's customers.

4. During the relevant period Respondent recommended approximately 484 short-term mutual fund transactions in the seven accounts held by the seven customers. As a result of the approximately 484 fraudulent and unsuitable short-term mutual fund transactions, Respondent's customers incurred unnecessary sales charges and fees amounting to about \$90,332, while Respondent received gross commissions of about \$105,111.

¹ A mutual fund switch occurs when a customer sells some or all of the assets contained in one mutual fund and uses the proceeds to purchase a different mutual fund.

5. Respondent exclusively sold Class A and Class B mutual fund shares, rather than Class C mutual fund shares to his customers, when available, even though he was recommending that his customers hold their mutual fund positions for short periods of time. Had Respondent recommended Class C shares during this period of short-term trading he could have substantially lowered his customers' expenses. The increased expenses of the Class A and B shares were not justified for any other reasons. The failure to recommend Class C mutual funds while recommending short holding periods was unsuitable under NASD Rules 2310 and 2110 due to his customers' objectives and financial situations.

6. Respondent also sold variable annuities to some of his customers. Respondent's variable annuity exchange recommendations to KM, LJ, and DM violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Rules 2120 and 2110, due to misrepresentations concerning the reasons for the exchanges as well as misrepresentations and omissions relating to the fees and expenses of the transactions.²

7. Respondent made unsuitable variable annuity exchange recommendations under NASD Rules 2310 and 2110, in light of his customers' objectives and financial situations, by exchanging his customers from one variable annuity to another where the exchanged variable annuity had been performing adequately, had been held for a short period of time, and the purchase of the new variable annuity did not improve the customers' financial situations.

² A variable annuity exchange occurs when a customer sells some or all of the assets contained in one variable annuity and uses the proceeds to purchase a different variable annuity.

8. Respondent violated NASD Rules 2510(b) and 2110 by executing mutual fund transactions in seven of his clients' accounts on a discretionary basis without receiving prior written trading authorization.

9. Respondent violated NASD Rules 3110 and 2110 by failing to provide his firm with correct and complete information relating to the mutual fund switches and variable annuity exchanges.

RESPONDENT AND JURISDICTION

10. The Department realleges and incorporates by reference paragraphs 1-9 above.

11. Respondent became registered as a general securities representative (Series 7) on or about March 2, 1983, and has been continuously in the industry since that time. From 2003 through most of 2008, Respondent was a registered representative at NEXT Financial Group, Inc. ("NEXT"). Respondent's office letterhead during the relevant period described him prominently as "Your Retirement Specialist."

12. On December 18, 2008, NEXT terminated Respondent for engaging in discretionary trading without written authority. Respondent has not been associated with any FINRA member or registered with FINRA in any capacity since that time. Following his termination at NEXT, Respondent has worked as the president and sole investment advisor at Associated Professional Investments LLC, which he owns.

13. Although Respondent has not been associated with a FINRA member firm since December 18, 2008, he remains subject to FINRA's jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because (1) the Complaint was filed within two years after the date upon which he ceased to be

associated with a FINRA member and (2) the Complaint charges him with misconduct committed while he was associated with a FINRA member.

FIRST CAUSE OF ACTION

Fraudulent Mutual Fund Switch Transactions Based on Excessive Trading and Misrepresentations and Omissions in Violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Rules 2120 and 2110

14. The Department realleges and incorporates by reference paragraphs 1-13 above.

15. Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and NASD Rule 2120 (the "antifraud rules"), collectively proscribe fraudulent conduct in connection with the "purchase or sale" of a security.

Respondent Engaged in a Pattern of Short-Term Mutual Fund Trading, Including Switching, in the Seven Customer Accounts

16. Between January 1, 2006, and December 31, 2007, Respondent engaged in an improper practice of excessively trading his customers' mutual funds. In 2006, Respondent's seven customers ranged in age from 66 to 93, were unsophisticated investors, were all retired, and, according to account information had annual incomes that ranged from \$30,000 to \$55,000 and liquid net worth's that ranged from \$50,000 to \$556,000. Six of the seven customers listed a risk tolerance of moderate in their account opening documents. All of the customers listed objectives of growth or growth and income.

17. Mutual funds are products generally intended to be held long-term. Respondent recommended and accomplished a short-term trading strategy in the seven customer accounts in which he repeatedly sold mutual funds less than one year after

purchasing them, and usually less than six months. The average holding period for a mutual fund purchased in the seven customer accounts, on behalf of the seven customers, during the relevant period was between 50 days and 74 days.

18. Many of the short-term transactions involved switching, whereby Respondent sold one mutual fund and invested some or all of the sale proceeds in other mutual funds, with little or no economic benefit to the customer.

19. Mutual funds are investment companies that collect money from multiple investors and invest in various different securities, such as stocks, bonds or commodities, with a common theme such as large cap or technology stocks or securities related to an index or geographical area. Mutual funds charge shareholder fees and annual operating expenses. One type of shareholder fee is a front-end load or sales charge. This fee typically goes to the broker selling the fund's shares. The maximum permitted sales load is 8.5% of the investment. Another type of fee is a deferred sales charge or back-end load that is paid when the investor sells his or her shares. The amount of the back-end load varies and depends on how long the investor holds his or her shares.³ The load typically decreases to zero if the shares are held long enough, usually five to ten years, but in some cases it can be shorter. Funds also charge for annual operating expenses including management fees and distribution and/or service fees.

20. The Class A mutual fund shares utilized by Respondent charged a front-end sales load in addition to annual operating expenses. The Class B mutual fund shares Respondent recommended charged a back-end sales load along with other annual operating expenses. Class C mutual fund shares, which Respondent did not recommend, could have front-end or back-end sales loads, in addition to annual operating expenses,

³ The most common back-end sales load is a contingent deferred sales charge.

but these loads would be substantially lower than the loads on the Class A or Class B shares Respondent utilized for purposes of short-term trading. Additionally, for Class C mutual fund shares with a back-end load, the period when the charge applied was much shorter than for a Class B mutual fund share. For the short-term mutual fund trading for the seven customers here, Respondent recommended mutual funds with front-end sales load of between 2.75% and 4.75% and back-end sales load of between .60% and 5%.

21. As disclosed in certain of the issuers' marketing material and prospectuses, the Class A and Class B mutual fund shares Respondent recommended to his customers were generally designed for long-term investors. For example, the prospectus for the AIM Asia Growth Pacific Fund, which was utilized by Respondent, explains that Class A shares are "[g]enerally more appropriate for long-term investors." Likewise, Class B shares with six-year or more back-end load periods are also more appropriate for long-term investors.

22. In purchasing mutual funds for his customers, Respondent exclusively utilized Class A and Class B mutual fund shares.

23. Respondent's goal was to hold funds for over a year. In July 2006, however, he began recommending that his customers hold their positions for "shorter" periods after economic conditions started changing in a way that did not "make sense" to him.

Respondent Omitted Material Information about Fees and Other Expenses

24. When Respondent recommended the short-term mutual funds trades, he did not discuss with the customers the different types of shares available for purchase, or the sales charges and operating expenses associated with each share class and their effect

on potential returns. Nor did Respondent disclose the potential contingent deferred sales charges ("CDSC") that could be levied upon the sale of these shares. Respondent also did not disclose cost-saving options that were available, such as purchasing Class C shares, retaining Class B shares until their annual expenses were reduced, or purchasing new funds in the same fund family to eliminate sales charges.

25. Respondent engaged in fraudulent conduct in the accounts of customers L.J., D.M. and R.M., R.A., R.S., R.B., and K.M. as a result of the size and frequency of the mutual fund switch recommendations he made and by omitting material information about the fees and expenses, such as front-end loads and CDSC, associated with these switch transactions prior to executing the transactions. Additionally, Respondent frequently failed to inform his customers of new CDSC periods they were entering when purchasing the new mutual funds. Moreover, he should have discussed Class C shares with these customers.

26. The information Respondent omitted in making the mutual fund switch transactions in his customers' accounts was material because the customers could not fairly evaluate the recommended switch transactions without understanding the reasons for the transactions and their costs.

27. As a result, Respondent caused his customers to incur \$90,332 in unnecessary costs in buying and selling their mutual funds. At the same time, he derived \$105,111 in commissions from these transactions in the accounts of his customers as described below. The benefit to the customers of this short-term trading did not justify the costs.

Respondent's Short-Term Trading Customers

Customer L.J.

28. In 2006, Customer L.J. turned 75 years old. At the time of the opening of the L.J. Revocable Trust Account in 2003, L.J., a high school graduate, was divorced, retired from her occasional work as a realtor and book-keeper, and had an annual income of \$30,000 and a liquid net worth of \$500,000. L.J., an unsophisticated investor, had no investment experience prior to opening an account with Respondent in the 1990s. L.J.'s risk tolerance, as listed in her account opening documents, was moderate and her investment objectives were growth and income. Respondent exercised de facto control over L.J.'s account.

29. Between January 2006 and December 2007, L.J.'s Revocable Trust Account held, on average, \$123,560 worth of mutual funds each month. During this time Respondent recommended 78 short-term mutual fund trades in L.J.'s account causing her to hold individual positions on average only 60 days for a 5.5 annualized turnover ratio. Respondent's actions caused L.J. to be charged \$23,926 in CDSC, front-end loads, and excessive trading fees on 31 of the 78 transactions for an annualized cost-to-equity ratio of 10%. Respondent obtained approximately \$14,409 in commissions on these transactions.

30. In making these short-term trades Respondent omitted material information about the fees and expenses, such as front-end loads and CDSC, associated with these transactions prior to executing them. He also did not discuss the different classes of shares available for purchase.

Customers D.M. and R.M.

31. Customers D.M. and R.M. are a married couple. In 2006, D.M. turned 73 years old and R.M. turned 74 years old. At the time of the opening of the D.M. Individual Retirement Account ("IRA") in 2005 and the Family Trust Account in 2003, D.M. and R.M. were retired, lived in a trailer-park, had an annual income of \$31,000 and a liquid net worth of \$556,000. D.M. and R.M. are both high school graduates. D.M. worked for about 40 years as a barber. R.M. worked occasionally as a teacher's aide and in other minimum wage positions. D.M. and R.M. are unsophisticated investors who first opened an account with Respondent in the 1980s. Both the IRA and Family Trust accounts, according to account opening information, had risk tolerances of moderate and investment objectives of growth and income. Respondent exercised de facto control over D.M.'s and R.M.'s accounts.

32. Between February 2006 and December 2007, D.M.'s IRA Account held, on average, \$93,225 worth of mutual funds each month. During this time Respondent recommended 75 short-term mutual fund trades in D.M.'s IRA Account causing him to hold individual positions on average only 61 days for a 5.6 annualized turnover ratio. Respondent's actions caused D.M. to be charged \$17,633 in CDSC, front-end loads, and excessive trading fees on 29 of the 75 transactions for an annualized cost-to-equity ratio of 10%. Respondent obtained approximately \$13,147 in commissions on these transactions.

33. Between January 2006 and December 2007, the Family Trust Account held, on average, \$131,335 worth of mutual funds each month. During this time Respondent recommended 94 short-term mutual fund trades in the Family Trust Account

causing it to hold individual mutual fund positions on average only 54 days for a 6.2 annualized turnover ratio. Respondent's actions caused the Family Trust Account to be charged \$25,633 in CDSC, front-end loads, and excessive trading fees in 35 of the 94 transactions for an annualized cost-to-equity ratio of 10%. Respondent obtained approximately \$19,974 in commissions on these transactions.

34. In making these short-term trades Respondent omitted material information about the fees and expenses, such as front-end loads and CDSC, associated with these transactions prior to executing them. He also did not discuss the different types of shares available for purchase.

Customers W.A., S.A. and R.A.

35. Customers W.A. and S.A., a married couple, opened the W.A. and S.A. Living Trust Account with Respondent in 2003. In 2006, W.A. and S.A. listed an annual income of \$32,000 and a liquid net worth of \$225,000. Their risk tolerance was moderate and their investment objective was growth. W.A. died in November 2006, when he was 93 years old. For about seven months prior to his death, W.A. suffered from dementia. In 2001, S.A., then 82, experienced a debilitating stroke and has been unable to communicate since then. W.A. and S.A. were both high school graduates who worked for an auto manufacturer. W.A. and S.A. were unsophisticated investors.

36. R.A., the son of W.A. and step-son of S.A., was added as a trustee to the account in 2006, when R.A. was 69 years old. R.A. is a high school graduate. In 2006, R.A. was retired and had very limited investment experience outside of 401(k) plans he participated in when he was working. Respondent exercised de facto control over the

W.A and S.A. Living Trust Account while R.A.'s father was alive and during the time that R.A. was the successor trustee.

37. Between September 2006 and June 2007, the W.A and S.A. Living Trust Account held, on average, \$266,851 worth of mutual funds each month.⁴ During this time Respondent recommended 28 short-term mutual fund trades in the Living Trust Account causing it to hold individual mutual fund positions on average only 74 days for a 3.5 annualized turnover ratio. Respondent's actions caused R.A. to be charged \$18,825 in CDSC, front-end loads, and excessive trading fees on 16 of the 28 transactions for an annualized cost-to-equity ratio of 8%. Respondent obtained approximately \$15,207 in commissions on these transactions.

38. In making these short-term trades Respondent omitted material information about the fees and expenses, such as front-end loads and CDSC, associated with these transactions prior to executing them. He also did not discuss the different types of shares available for purchase.

Customer R.S.

39. In 2007, Customer R.S. turned 66 years old. At the time of the opening of the R.S. Account in March 2007, she was retired and worked as a part-time school administrator in Oregon with an annual income of \$55,000 and a liquid net worth of \$300,000. R.S. inherited her account from her parents. R.S. is an unsophisticated investor who had very limited investment experience before opening an account with Respondent. R.S.'s listed risk tolerance was moderate and her investment objective was growth. She has never met Respondent in person. Respondent exercised de facto control over R.S.'s account.

⁴ R.A. closed the account in June 2007.

40. Between March 2007 and December 2007, the R.S. Account held, on average, \$171,928 worth of mutual funds each month. During this time Respondent recommended 35 short-term mutual fund trades in R.S.'s account causing it to hold individual mutual fund positions on average only 50 days for a 4.9 annualized turnover ratio. Respondent's actions caused R.S. to be charged \$7,800 in CDSC, front-end loads, and excessive trading fees in 11 of the 35 for an annualized cost-to-equity ratio of 5%. Respondent obtained approximately \$7,942 in commissions on these transactions.

41. In making these short-term trades Respondent omitted material information about the fees and expenses, such as front-end loads and CDSC, associated with these transactions prior to executing them. He also did not discuss the different types of shares available for purchase.

Customer R.B.

42. In 2006, Customer R.B. turned 79 years old. At the time of the opening of the R.B. IRA Account in 2004, he was retired and had an annual income of \$47,000 and a liquid net worth of \$290,000. R.B. was a high school graduate who had taken some college-level courses, none of which involved finance. He worked for 27 years at a telecommunications company as a technician before retiring in 1989. R.B. is an unsophisticated investor who had very limited investment experience before opening an account with Respondent. R.B.'s risk tolerance, according to his account opening information, was moderate and his investment objectives were growth and income. Respondent exercised de facto control over R.B.'s account.

43. Between January 2006 and December 2007, the R.B. Account held, on average, \$37,124 worth of mutual funds each month. During this time Respondent

effected 63 short-term mutual fund trades in the account causing it to hold individual mutual fund positions on average only 62 days for a 6.3 annualized turnover ratio. Respondent's actions caused R.B. to be charged \$7,115 in CDSC, front-end loads, and excessive trading fees in 20 of the 63 short-term transactions for an annualized cost-to-equity of 10%. Respondent obtained approximately \$3,866 in commissions on these transactions.

44. In making these short-term trades Respondent omitted material information about the fees and expenses, such as front-end loads and CDSC, associated with these transactions prior to executing them. He also did not discuss the different types of shares available for purchase.

Customer K.M.

45. In 2006, Customer K.M. turned 72 years old. At the time of the opening of the K.M. IRA Account in 2003, K.M., a resident of Chicago, IL, was a retired school teacher and had an annual income of \$45,000 and a liquid net worth of \$50,000. K.M.'s listed risk tolerance was aggressive and her investment objective was growth. Respondent exercised de facto control over K.M.'s account.

46. Between January 2006 and July 2007, the K.M. Account held, on average, \$443,840 worth of mutual funds each month. During this time Respondent recommended 111 short-term mutual fund trades in the account causing it to hold individual mutual fund positions on average only 62 days for a 5.4 annualized turnover ratio. Respondent's actions caused K.M. to be charged \$47,082 in CDSC, front-end loads, and excessive trading fees on 36 of the 111 short-term mutual fund trades for an annualized cost-to-

equity of 7%. Respondent obtained approximately \$30,566 in commissions on these transactions.

47. In making these short-term trades Respondent omitted material information about the fees and expenses, such as front-end loads and CDSCs, associated with these transactions prior to executing them. He also did not discuss the different types of shares available for purchase.

Respondent's Transactions Utilized Interstate Commerce

48. As part of the course of conduct described in paragraphs 14-47 above, Respondent, in connection with the purchase or sale of the various mutual funds at issue, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, knowingly or recklessly: employed devices, schemes or artifices defraud; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon any person; or effected transactions in, or induced the purchase or sale of these mutual funds by means of any manipulative, deceptive or other fraudulent device or contrivance.

SECOND CAUSE OF ACTION

Unsuitable Mutual Fund Switch Transactions in Violation of NASD Rules 2310 and 2110 and IM-2310-2(b)(3)

49. The Department realleges and incorporates by reference paragraphs 1-48 above.

50. NASD Rule 2310(a) provides that an associated person, such as Respondent, who recommends to a customer "the purchase, sale or exchange of any security" must have "reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." IM-2310-2(b)(3) provides that ordinarily mutual funds are not appropriately treated as short-term trading vehicles.

51. Between January 1, 2006, and December 31, 2007, Respondent repeatedly recommended short-term mutual fund transactions without having reasonable grounds for believing that such recommendations were suitable for L.J., D.M. and R.M., R.A., R.S., R.B., and K.M. As a result, he caused these customers to engage in short-term buying and selling of mutual funds that was unsuitable in light of the size, frequency, the nature of the transactions, and each customer's investment objectives, financial situation, and needs.

52. All of these customers were elderly and retired; had relatively modest annual incomes and liquid net worth; were unsophisticated investors, and all but one had moderate risk tolerances. They relied upon Respondent to choose investments and place trades in their accounts, usually without first contacting the customer. None of the customers provided Respondent with written discretionary authority over their accounts. As a result of Respondent's trading recommendations the customers incurred unnecessary fees, penalties, and other expenses.

53. By virtue of the foregoing, Respondent violated NASD Rules 2310 and 2110 and IM-2310-2(b)(3).

THIRD CAUSE OF ACTION

Unsuitable Sale of Class A and B Mutual Fund Shares in Violation of NASD Rules 2310 and 2110

54. The Department realleges and incorporates by reference paragraphs 1-53 above.

55. Between January 1, 2006, and December 31, 2007, Respondent exclusively recommended that L.J., D.M. and R.M., R.A., R.S., R.B., and K.M. purchase Class A and B mutual fund shares in their brokerage accounts.

56. In recommending that his customers purchase Class A and Class B mutual fund shares instead of Class C mutual fund shares, while also advising, as described above, that they switch their mutual fund holdings on average every two months, Respondent violated NASD Rule 2310's requirement that a registered representative "shall have reasonable grounds for believing that the recommendation is suitable."

57. Respondent placed the customers identified above in Class B mutual fund shares. Class B mutual fund shares have a CDSC or back-end sales charge that requires the holder to pay a penalty for selling the fund before a set period of time has expired. The penalties are highest in the initial years of ownership and gradually diminish over a set period of time, most commonly, five years. For the customers listed above, the highest CDSC was 5%. For example, on June 11, 2007, after holding the AIM Global Healthcare Fund Class B fund for 35 days, K.M. sold her position in the fund, worth \$14,307, and paid CDSC in the amount of \$715, or 5%.

58. Respondent also sold the customers above Class A mutual fund shares which charged a front-end sales load. For the customers listed above, the highest front-end sales charge was 4.75%. For example, on May 26, 2006, K.M. purchased \$40,745

worth of Rydex Inverse Russell 2000 Class A shares which included a front-end sales charge of \$1,935 or 4.75%, and held it for only 150 days.

59. Class C mutual fund shares, like Class B mutual fund shares, do not charge a front-end load. However, unlike Class B fund shares, Class C shares ordinarily charge one percent of the sales price if a customer sells the shares within the first year.

60. By recommending that these customers invest in Class A and B shares and engage in frequent exchanges, Respondent caused his customers to incur more than \$90,333 in unsuitable fees, with the following break-down by customer:

- a. L.J., \$13,961;
- b. D.M. and R.M. Family Trust Account, \$16,506;
- c. D.M., \$10,752;
- d. R.A., \$12,322;
- e. R.S., \$5,701;
- f. R.B., \$4,589; and
- g. K.M., \$26,502.

61. As a result, in light of the short holding periods that Respondent recommended to his customers and based on the financial situation and needs of his customers, these transactions were unsuitable.

62. By virtue of the foregoing, Respondent violated NASD Rules 2310(a) and 2110.

FOURTH CAUSE OF ACTION

Fraudulent Variable Annuity Exchange Transactions Based on Misrepresentations and Omissions in Violation of Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 thereunder, and NASD Rules 2120 and 2110

63. The Department realleges and incorporates by reference paragraphs 1-62 above.

64. Between January 1, 2006, and May 8, 2006, Respondent also made variable annuity exchange recommendations to three different customers in three accounts that were improper. Variable annuities are contracts between a customer and an insurance company which are designed to provide tax deferred returns for the customer if certain conditions are met. A customer who purchases a variable annuity makes either a lump sum payment or pays premiums which are invested in one or more subaccounts that are similar to mutual funds, or an investment portfolio. As a result, the returns on the variable annuity investment are a function of the performance of the underlying investments. Another feature of variable annuities is a death benefit. Similar to mutual funds, variable annuities have CDSC for early withdrawals. Because of the fees, expenses, and penalties for early withdrawals, variable annuities are ordinarily most appropriate as long-term investments.

65. Respondent made frequent recommendations to his customers to exchange, or liquidate variable annuities they held in order to fund the purchases of new variable annuities. For example, between 2000 and 2006, Respondent sold L.J. ten variable annuities and during the same time sold D.M. and R.M. 14 variable annuities. The vast majority of these sales resulted from exchanges. During the four-month period between January 1, 2006 and May 8, 2008, Respondent exchanged K.M., L.J., and D.M.

out of variable annuities they had held for only a short amount of time and into new annuities.

66. Respondent fraudulently induced K.M., L.J., and D.M. to make variable annuity exchanges by misrepresenting the need for the exchanges and omitting material information about the costs associated with the transactions, including CDSCs and bonus rider fees.

K.M. Variable Annuity Exchange

67. On May 8, 2006, Respondent recommended that K.M. surrender her \$232,811 American Skandia XTra Credit Six Variable Annuity in order to purchase a Security Benefit Life Advisor Designs Variable Annuity. K.M. had held the American Skandia XTra Credit Six Variable Annuity for about 27 months after purchasing it through Respondent. As a result of Respondent's recommendation, K.M. incurred \$13,368 in surrender charges.

68. According to the Variable Annuity Disclosure Letter prepared at Respondent's direction, the reason for the exchange was that K.M. had "not be[en] satisfied from a relative standard because of the lack of flexibility in reallocation & performance." However, the American Skandia Annuity had returned more than 40% during the time that K.M. held it compared with a return of about 21% for the S&P 500 during the same period. K.M. had not planned to exchange the American Skandia Annuity prior to Respondent's recommendation that she do so. Respondent misrepresented to K.M. that there was a need to exchange her annuity.

69. Respondent also informed K.M. that the Security Benefit Life Annuity would pay the costs of the surrender fee by providing her with a bonus in the same

amount of the fee. Respondent, however, omitted the material information that K.M. was actually purchasing a rider to pay back the bonus amount over time that increased her expenses.

L.J. Variable Annuity Exchange

70. On January 11, 2006, Respondent recommended that L.J. surrender her \$50,940 American Skandia XTra Credit Six Variable Annuity Contract in order to purchase a Security Benefit Life Advisor Designs Variable Annuity. L.J. had held the American Skandia XTra Credit Six Variable Annuity for about nine months after purchasing it from Respondent. As a result of Respondent's recommendation, L.J. incurred \$3,800 in surrender charges.

71. According to the Variable Annuity Disclosure Letter prepared at Respondent's direction, the reason for the exchange was that the "Skandia contract has not performed satisfactorily over the years mostly due to restrictive policies." Respondent recommended the exchange to L.J., in part, based on the bonus offered by the Security Benefit Life Annuity. Respondent, however, omitted material information in his discussions with L.J. because he failed to explain that L.J. was actually purchasing a rider to pay back the bonus amount over time that increased her expenses. Additionally, Respondent omitted material information about the CDSC that L.J. had to pay in order to sell the American Skandia Annuity.

D.M. Variable Annuity Exchange

72. On January 6, 2006, Respondent recommended that D.M. surrender his \$184,000 Lincoln Choice Plus Assurance Variable Annuity in order to purchase an American Skandia XTra Credit Six Variable Annuity. D.M. had held the Lincoln

ChoicePlus Assurance Variable Annuity for less than nine months after purchasing it from Respondent. As a result of Respondent's recommendation, D.M. incurred about \$10,000 in surrender charges.

73. According to the Variable Annuity Disclosure Letter, prepared at Respondent's direction, the reason for the exchange was that "Lincoln has performed unsatisfactory (sic) for us and we already have had a great experience with Skandia." This statement omitted material information as the Lincoln variable annuity had returned about 20% by December 31, 2005, which was almost twice as much as the approximate 11% return of the S&P 500 during the same period. Respondent misrepresented to D.M. that there was a need to exchange his annuity.

Respondent's Transactions Utilized Interstate Commerce

74. As part of the course of conduct described in paragraphs 14-47 above, Respondent, in connection with the purchase or sale of the various mutual funds at issue, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, knowingly or recklessly: employed devices, schemes or artifices defraud; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon any person; or effected transactions in, or induced the purchase or sale of these mutual funds by means of any manipulative, deceptive or other fraudulent device or contrivance

75. As a result of Respondent's omissions and misrepresentations he caused these three customers to engage in unnecessary variable annuity exchanges and needlessly incur approximately \$27,168 in surrender charges.

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

FIFTH CAUSE OF ACTION

Unsuitable Variable Annuity Exchange Transactions in Violation of NASD Rules 2310 and 2110 and IM-2310-2(a)

77. The Department realleges and incorporates by reference paragraphs 1-76 above.

78. For the reasons described in paragraphs 67-76, between January 1, 2006, and December 31, 2007, Respondent caused his customers K.M., L.J., and D.M. to make unsuitable and unnecessary variable annuity exchanges in light of their financial objectives and resources and the fees and expenses incurred through the exchanges. NtM 96-86: *NASD Regulation Reminds Members and Associated Persons that Sales of Variable Contracts are Subject to NASD Suitability Requirements*, advises representatives not to "replace a customer's existing variable contract with a new variable contract that doesn't improve the customer's existing position" Respondent ignored this guidance. Respondent caused K.M., L.J. and D.M., who were all elderly, retired, and had relatively modest annual incomes, to incur unnecessary fees and penalties as a result of Respondent's trading recommendations. Respondent variable annuity exchange recommendations were unsuitable.

79. By virtue of the foregoing, Respondent violated NASD Rules 2310 and 2110 and IM-2310-2(a).

SIXTH CAUSE OF ACTION

**Discretionary Trading Without Prior Written Authorization in
Violation of NASD Rules 2510(b) and 2110**

80. The Department realleges and incorporates by reference paragraphs 1-79 above.

81. NASD Rule 2510(b) provides that "[n]o member or registered representative shall exercise any discretionary power in a customer's account unless such customer has given prior written authorization to a stated individual or individuals and the account has been accepted by the member"

82. Between January 1, 2006, and December 31, 2007, Respondent traded mutual funds in the accounts of customers L.J., D.M. and R.M., R.S., R.B., R.A. and K.M. without contacting them prior to executing transactions in their accounts.

83. None of these customers provided Respondent with prior written discretionary authority over their accounts and none of the accounts had been accepted by NEXT as discretionary accounts.

84. As a result, Respondent exercised discretion without proper written authorization by selling and buying numerous mutual funds without obtaining prior approval by the customers.

85. By virtue of the foregoing, Respondent violated NASD Rules 2510(b) and 2110.

SEVENTH CAUSE OF ACTION

Inaccurate Books and Records in Violation of NASD Rules 3110 and 2110

86. The Department realleges and incorporates by reference paragraphs 1-85 above.

87. NASD Rule 3110(a) requires member firms to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations, and statements of policy promulgated thereunder and with the Rules of this Association and as prescribed by SEC Rule 17a-3." SEC Rule 17a-3 provides that member firms must, among other things, make "[a] memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities" The memorandum must show, among other things, "the time the order was received" and, if "feasible, the time of execution"

88. NEXT's written supervisory procedures in 2006 and 2007, required its representatives to inform its customers of material facts regarding their mutual fund switch and variable annuity exchange transactions on mutual fund switch and variable annuity exchange disclosure forms.

89. In transactions with L.J., D.M. and R.M., R.S., R.B., R.A. and K.M., Respondent utilized Mutual Fund Disclosure Forms and Variable Annuity Disclosure Letters provided by NEXT that were designed to notify customers prior to the execution of an exchange the terms of a particular purchase, switch, or exchange and give them material information about the transaction such as the reason for the transfer, any CDSC incurred as a result of the transfer, whether a new CDSC period was triggered by the switch, and any other fees and costs that would be incurred, such as a front-end load. These reporting procedures were put in place so that the firm could maintain accurate

records of mutual fund switches and variable annuity exchanges in order to adequately monitor them.

90. Respondent did not comply with these mutual fund switch and variable annuity exchange recordkeeping requirements during the relevant period. Respondent, or at his instruction, his staff, omitted material information on the mutual fund disclosure forms, that he sent to his customers, or had them sign in his office. For example, Respondent, with the customers described above, failed to include front-end load, CDSC, surrender time-period, and maximum CDSC information on the disclosure forms he provided to his customers as required by NEXT to evidence their awareness of the material information relevant to the transaction prior to its execution.

91. Respondent also predated, or caused to be predated, the client signature line for customers L.J., D.M. and R.M., R.S., R.B., R.A. and K.M., prior to mailing them to the customers for their signature. This had the effect of making it appear that his customers were aware of certain fees before trades were executed as required by the firm's written procedures. In fact, the clients were not aware of the fees prior to execution.

92. Respondent also provided false, inaccurate, and misleading information on the forms about the reasons his customers made variable annuity exchanges at his recommendation as described above. He also added information to forms after they were signed. By virtue of the foregoing, Respondent caused the books and records of his firm to be false and violated NASD Rules 3110 and 2110.

RELIEF REQUESTED

WHEREFORE, the Department respectfully requests that the Panel:

- A. Enter findings of fact and conclusions of law that the Respondent committed the violations charged and alleged herein;
- B. Order that one or more of the sanctions provided under FINRA Rule 8310(a) be imposed, including that the Respondent be required to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest.
- C. Order that the Respondent bear such costs of proceeding as are deemed fair and appropriate under the circumstances in accordance with FINRA Rule 8330.
- D. Make specific findings that Respondent willfully violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder of the Exchange Act.

FINRA DEPARTMENT OF ENFORCEMENT

Date: September 8, 2010

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