

**FINANCIAL INDUSTRY REGULATORY AUTHORITY
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

DANIEL G. SHARP
(CRD No. 2194385),

Respondent.

Disciplinary Proceeding
No. 2011029681602

Hearing Officer – Andrew H. Perkins

DEFAULT DECISION

March 6, 2014

Respondent is suspended in all capacities for two years and fined \$12,587.56 for recommending and effecting unsuitable switches from Class A shares of mutual funds to shares of unit investment trusts, in violation of NASD Rule 2310 and FINRA Rule 2010. Respondent is also suspended in all capacities for 18 months and fined an additional \$10,000 for untimely responses to FINRA Rule 8210 requests to provide on-the-record testimony, in violation of FINRA Rules 8210 and 2010. The suspensions shall run concurrently.

Appearances

David F. Newman, Sr., Esq., for the Department of Enforcement.

No appearance by or for Respondent Daniel G. Sharp.

DECISION

The Department of Enforcement filed the two-cause Complaint in this disciplinary proceeding on October 7, 2013. The First Cause of Action charges Respondent Daniel G. Sharp with violating NASD Rule 2310 and FINRA Rule 2010 by making unsuitable recommendations to customers to switch from Class A mutual funds shares to unit investment trusts (“UITs”).¹ The Second Cause of Action charges Sharp with violating FINRA Rules 8210 and 2010 by

¹ Effective October 7, 2011, after the unsuitable transactions that are the subject of the Complaint had been completed, NASD Rule 2310 was superseded by FINRA Rule 2111. See Reg. Notice 11-02.

failing to appear timely for an on-the-record interview ("OTR"). Sharp did not file an Answer or otherwise respond to the Complaint.

On January 15, 2014, Enforcement filed a Motion for Entry of Default Decision, to which Sharp did not respond. Enforcement's motion is granted. Accordingly, pursuant to FINRA Rules 9215(f) and 9269, the Hearing Officer finds that Sharp has defaulted, and the allegations of the Complaint are deemed admitted.²

I. Background and Jurisdiction

Sharp was first registered with FINRA in 1991. He was continuously registered until October 2011. Decl. ¶ 6; CX-1. In September 2009, Sharp was registered and employed by FINRA member firm The Huntington Investment Company ("Huntington"), where he remained employed until October 10, 2011. On October 11, 2011, Huntington filed a Uniform Termination Notice for Securities Industry Registration (Form U5), reporting that Sharp's employment had been terminated on October 10, 2011, for failing to cooperate fully with Huntington's investigation of his trading practices.³ Decl. ¶ 8; CX-1. Sharp has not been registered with any FINRA member firm since October 11, 2011. Decl. ¶ 9; CX-1.

Although Sharp is not registered with a FINRA member firm, he remains subject to FINRA's jurisdiction for purposes of this proceeding, pursuant to Article V, Section 4 of FINRA's By-Laws, because the Complaint was filed within two years after the termination of his registration with a member firm, and it charges him with misconduct while he was registered

² The factual determinations in this decision are based on the allegations of the attached Complaint and the materials Enforcement filed with its default motion, which include the Declaration in Support of Motion for Entry of Default Decision, signed by David F. Newman, counsel for Enforcement, and five exhibits that are appended to the declaration. The declaration is cited herein as "Decl. ¶ ____." The exhibits are cited as "CX- ____."

³ FINRA Staff began an investigation that led to the filing of the Complaint as a result of receipt of the Form U5. Decl. ¶ 22.

with a member firm and with failure to comply with Rule 8210 requests issued within two years after his FINRA registration terminated.

II. Sharp Defaulted by Failing to Answer the Complaint

On October 7, 2013, Enforcement served Sharp with the First Notice of Complaint and Complaint, by first-class and certified mail, at Sharp's residential address as listed in the Central Registration Depository ("CRD"). Decl. ¶ 10; CX-2. The first-class mailing was not returned to Enforcement. The certified mailing was returned to Enforcement, marked "Unclaimed." Decl. ¶ 11; CX-2. Sharp was required to file an Answer to the Complaint by November 4, 2013, but failed to do so. Decl. ¶¶ 13, 14.

On November 12, 2013, Enforcement served a Second Notice of Complaint and Complaint on Sharp at his CRD address by first-class and certified mail. The first-class mailing was not returned. The Postal Service returned the certified mailing to Enforcement, marked "Return to Sender" and "Refused." Decl. ¶¶ 15-17; CX-3. Sharp was required to file an Answer to the Complaint by November 29, 2013. He has not filed an Answer or otherwise responded to the Complaint. Decl. ¶¶ 19-21.

The Hearing Officer concludes that Sharp received valid constructive notice of this proceeding and thereby defaulted by failing to file an Answer or otherwise respond to the Complaint, as required by Rule 9215(f).

III. First Cause of Action: Sharp Violated NASD Rule 2310 and FINRA Rule 2010 by Recommending Unsuitable Switches from Mutual Funds to Unit Investment Trusts

Sharp engaged in a pattern of recommending unsuitable switches from Class A mutual fund shares, which his customers had held for a short time, to UITs, causing his customers to incur unnecessary sales charges. By making these unsuitable recommendations, Sharp violated NASD Rule 2310 and FINRA Rule 2010.

A. A Pattern of Mutual Fund Switches, Including Switches from Mutual Funds to UITs, is Presumptively Unsuitable

Class A mutual funds require customers who purchase the fund's shares to pay a sales charge, known as a "front-end load."⁴ Generally, UITs are investment companies that offer redeemable shares or units of a fixed portfolio of securities in a one-time public offering. UITs are baskets of stocks or bonds, often composed of the securities of companies within a specific sector of the economy, that form a defined portfolio for a pre-determined period of time. Unlike a typical mutual fund, a UIT is not actively managed, meaning that the portfolio generally will not change during the course of the UIT's existence regardless of any changes in market circumstances.⁵ Investors in UITs often must pay an upfront sales charge.⁶

NASD Rule 2310(a) requires that a registered representative, before recommending the purchase, sale, or exchange of any security, "have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customers as to his other security holdings and financial situation and needs." A pattern of mutual fund switching is presumptively unsuitable, and therefore presumptively a violation of Rule 2310(a). "Mutual fund shares generally are suitable only as long-term investments and cannot be regarded as a proper vehicle for short-term trading, especially where such trading

⁴ *Dep't of Enforcement, v. Wilson*, No. 2007009403801, 2011 FINRA Discip. LEXIS 67, at *10 n.7 (N.A.C. Dec. 28, 2011), citing *Scott Epstein*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at *7 n.8 (Jan. 30, 2009), *aff'd*, 416 F. App'x 142 (3d Cir. 2010).

⁵ *Luis Miguel Cespedes*, Exchange Act Rel. No. 59404, 2009 SEC LEXIS 368, at *5 (Feb. 13, 2009); NTM 04-26, 2004 NASD LEXIS 28 (Mar. 31, 2004). Section 4(2) of the Investment Company Act of 1940 defines a UIT as "an investment company which (A) is organized under a trust indenture, contract of custodianship or agency, or similar instrument, (B) does not have a board of directors, and (C) issues only redeemable securities, each of which represents an undivided interest in a unit of specified securities; but does not include a voting trust." 15 U.S.C. §80a-4(2).

⁶ See NASD NTM 04-26 (Mar. 2004).

involves new sales loads.”⁷ “Where such a pattern is established, it is incumbent upon the registered representative that recommended such switches to demonstrate the unusual circumstances which justified what is a clear departure from the manner in which mutual fund investments are normally made.”⁸ A registered representative “must evaluate the net investment advantage of any recommended switch from one fund to another” and must be able to demonstrate the rationale for the recommendation based upon the information obtained from the customer for the purpose of making a suitability determination.⁹ The same considerations apply to switches among UITs, and between UITs and mutual funds.¹⁰

B. Sharp Recommended and Effected Unsuitable Switches from Class A Mutual Fund Shares to UITs

From July 15, 2011, until about September 9, 2011 (the “Relevant Period”), Sharp made 38 unsuitable switches of Class A mutual funds to UITs in the accounts of 13 customers. In most cases, the Class A shares had been held for less than one year, and none had been held for more than 16 months. The customers had paid front-end fees of \$17,915.29 for the purchase of the Class A shares, and paid front-end fees of \$8,533.09 for the purchase of the UITs. Complaint ¶ 1. All the transactions were effected in retirement accounts. Complaint ¶ 11.

The customers’ ages ranged from 37 years old to 63 years old, and all had “capital appreciation” as their primary investment objective, with some having a secondary objective of “income.” Complaint ¶ 12. The Class A mutual fund shares in nine customer accounts had been

⁷ *Dep’t of Enforcement, v. Wilson*, 2011 FINRA Discip. LEXIS 67, at *17, quoting *Kenneth C. Krull*, 53 S.E.C. 1101, 1104 (1998), *aff’d*, 248 F.3d 907 (9th Cir. 2001).

⁸ *Dep’t of Enforcement v. Epstein*, No. C9B040098, 2007 FINRA Discip. LEXIS 18, at *67 (N.A.C. Dec. 20, 2007), *aff’d*, 2009 SEC LEXIS 217 (Jan. 30, 2009), *aff’d*, *Scott Epstein*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217 (Jan. 30, 2009), *aff’d*, 416 F. App’x 142 (3d Cir. 2010).

⁹ NASD Notice to Members 94-16.

¹⁰ *See, Dist. Bus. Conduct Comm. v. Koppel-Heath*, No. C02950044, 1998 NASD Discip. LEXIS 10 (N.B.C.C. Jan. 6, 1998); *J. Stephen Stout*, Exchange Act Rel. No. 43410, 2000 SEC LEXIS 2119 (Oct. 4, 2000).

held for 12 months or less, and in four customer accounts the Class A shares had been held for 16 months or less when Sharp effected the sales. Complaint ¶ 13. All of the Class A shares had been subject to a front-end sales load of at least 5%. Complaint ¶ 14. The UITs Sharp purchased for the accounts had sales charges of up to 3.5%, with the customer paying a 1% load up front, and the balance through a possible contingent deferred sales charge ("CDSC"). Complaint ¶ 15.

Following the trades, Huntington required Sharp to provide switch letters explaining his rationale for the trades. But Sharp had no rational explanation for the recommendations. For example, where Sharp asserted that some switches addressed purported customer concerns about market volatility, a need for diversification and lower exposure to equities, he could not explain why some of his customers were switched into UITs that had more equity exposure and a narrower focus than their mutual fund holdings. Complaint ¶ 16. In fact, the switches made no economic sense. Sharp did not have reasonable grounds for believing that his recommendations, and the transactions, were suitable for the customers. Complaint ¶¶ 2, 10.

Huntington refunded the \$17,915.29 in front-end fees that customers had paid in connection with the Class A shares that were sold to purchase the UITs. Complaint ¶ 19. The customers paid \$8,533.09 in front-end fees to purchase the UITs. Sharp received \$2,587.76 in commissions for the UIT purchases. Complaint ¶ 20.

The allegations of the Complaint establish that Sharp violated NASD Rule 2310 and FINRA Rule 2010 by recommending and effecting unsuitable switches from Class A shares of mutual funds to UITs.

IV. Second Cause of Action: Sharp Violated FINRA Rules 8210 and 2010

Sharp twice failed to appear and testify at OTRs for which he had received proper notice. He finally appeared and testified only after receiving a Notice of Suspension, and being

suspended by FINRA, for failing to appear at his two previous OTRs. Sharp thereby violated FINRA Rules 8210 and 2010.

FINRA Rule 8210 requires persons subject to FINRA's jurisdiction to provide information requested by FINRA orally or in writing in response to requests for information. "[C]ompliance with Rule 8210 [is] essential to enable NASD to execute its self-regulatory functions."¹¹ A violation of FINRA Rule 8210 is also a violation of FINRA Rule 2010.¹²

On March 12, 2012, pursuant to FINRA Rule 8210, FINRA's Member Regulation Staff sent a letter to Sharp at his CRD address, requesting his appearance at an OTR on April 11, 2012. CX-4, at 1. The purpose of the OTR was to obtain information concerning the switches that are the subject of the First Cause of Action. Complaint ¶ 23. On March 16, 2012, Sharp telephoned the Staff and represented that appearing in person for the OTR would be a hardship due to family-related issues. At Sharp's request, the Staff agreed to conduct the OTR on April 11, 2012, by telephone. Complaint ¶ 24. The Staff confirmed the April 11 OTR by telephone and by mail. CX-4, at 2. Sharp failed to appear at his OTR on April 11, 2012. Complaint ¶ 25.

On April 23, 2012, the Staff sent a letter to Sharp at his CRD address by first-class and certified mail, requesting that he appear for an OTR on April 30, 2012. Sharp failed to appear for the OTR. Complaint ¶ 26.

On July 19, 2012, Enforcement served Sharp with a FINRA Rule 9552 Notice of Suspension for his failure to appear at the two scheduled OTRs. On August 13, 2012, Sharp was suspended from associating with any FINRA member in any capacity. Thereafter, Sharp

¹¹ *Dep't of Enforcement v. Hedge Fund Capital Partners, LLC*, No. 2006004122402, 2012 FINRA Discip. LEXIS 42, at *63-64 (N.A.C. May 1, 2012), quoting *PAZ Sec, Inc.*, Exchange Act Rel. No. 57656, 2008 SEC LEXIS 820, at *12 (Apr. 11, 2008), *aff'd*, 566 F.3d 1172 (D.C. Cir. 2009).

¹² *Dep't of Enforcement v. Hoeper*, No. C02000037, 2001 NASD Discip. LEXIS 37, at *5 (N.A.C. Nov. 2, 2001) (violation of NASD Procedural Rule 8210 was a violation of NASD Conduct Rule 2110).

contacted the Staff and indicated he was willing to testify. Complaint ¶ 27. Sharp appeared for an OTR on September 7, 2012. Complaint ¶ 28.

The allegations of the Complaint establish that Sharp violated FINRA Rules 8210 and 2010 by failing to appear and testify timely in connection with FINRA's investigation into his unsuitable recommendations.

V. Sanctions

The Hearing Officer suspends Sharp in all capacities for two years and fines him \$12,587.56 for making unsuitable recommendations. The Hearing Officer imposes a concurrent suspension of 18 months in all capacities, and an additional \$10,000 fine, for his untimely responses to FINRA Rule 8210 requests for testimony.

A. Sanction for Suitability Violations (NASD Rule 2310 and FINRA Rule 2010)

For making unsuitable recommendations in violation of NASD Rule 2310, the FINRA Sanction Guidelines recommend a fine of \$2,500 to \$75,000, a suspension of 10 business days to one year, and a longer suspension or a bar in egregious cases. The Principal Considerations are those applicable to all violations.¹³ The Sanction Guidelines also recommend consideration of disgorgement.¹⁴

Enforcement seeks a suspension of six months and a fine of \$12,587.56, which includes disgorgement of Sharp's commissions, for the switching violations charged in the First Cause of Action. Enforcement notes the following factors: the number of switches; the economic harm or potential harm to the customers; Sharp's financial motivation for his actions; and his lack of remorse and acknowledgement of wrongdoing.

¹³ FINRA Sanction Guidelines at 94 (2011).

¹⁴ *Id.* n.2.

Sharp's violation is egregious, and strong sanctions are appropriate. The mutual fund switches are explainable only by Sharp's need to generate commissions. On August 16, 2011, Sharp had been placed on a 30-day Performance Improvement Program ("PIP") due to decreased production. At least 21 of the 32 unsuitable switches that Sharp recommended and effected occurred after he was placed on the PIP. Complaint ¶ 17.

A recommendation that is based on generating commissions violates the suitability rule, and "warrants serious sanctions."¹⁵ Although the appropriate sanction depends on the facts and circumstances of each case, the Hearing Officer notes that in several previous mutual fund switching cases FINRA has imposed sanctions more severe than the six month suspension Enforcement requests in this case.¹⁶ The Hearing Officer imposes a two-year suspension in all capacities and a fine of \$12,587.56.

B. Sanction for Untimely Response to Rule 8210 Requests to Testify at an OTR (FINRA Rules 8210 and 2010)

For failure to respond to Rule 8210 requests in a timely manner, the Sanction Guidelines recommend a fine of \$2,500 to \$25,000 and a suspension of up to two years. The Principal Considerations are the importance of the information requested, the number of requests made and the degree of regulatory pressure required to obtain a response, and the length of time to respond.¹⁷

Enforcement seeks a suspension of 18 months in all capacities and a \$10,000 fine.

Enforcement notes that the information was important, and a significant degree of regulatory

¹⁵ *Scott Epstein*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217, at *70-72.

¹⁶ See, *Dep't of Enforcement v. Wilson*, No. 2007009403801, 2011 (barred for recommending switches to ten customers); FINRA Discip. LEXIS 67; *Scott Epstein*, Exchange Act Rel. No. 59328, 2009 SEC LEXIS 217 (barred for recommending switches to 12 customers); *Dep't of Enforcement v. Belden*, No. C05010012, 2002 NASD Discip. LEXIS 12, at *15 (N.A.C. Aug. 13, 2002) (\$40,000 fine, a one-year suspension, and restitution ordered for recommending a switch for one customer); *Dep't of Enforcement v. Fantetti*, No. C3A040030, 2005 NASD Discip. LEXIS 57 (O.H.O. July 18, 2005) (one-year suspension and \$25,000 fine for switches in two customer accounts).

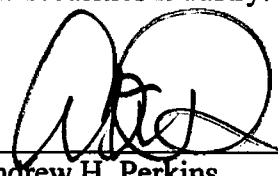
¹⁷ Sanction Guidelines at 33.

pressure was required to compel Sharp to testify. Enforcement's recommendation is reasonable. Sharp is suspended for 18 months in all capacities, with the suspension to run concurrently with the suspension for unsuitable recommendations. Sharp is fined \$10,000 for his Rule 8210 violation, in addition to the fine imposed for the First Cause of Action.

VI. Order

Daniel G. Sharp is suspended in all capacities from association with any FINRA member firm for two years and fined \$12,587.56 for recommending and effecting unsuitable switches from Class A shares of mutual funds to unit investment trusts, in violation of NASD Rule 2310 and FINRA Rule 2010. Sharp is also suspended in all capacities for 18 months and fined an additional \$10,000 for untimely responses to FINRA Rule 8210 requests to provide on-the-record testimony, in violation of FINRA Rules 8210 and 2010. The suspensions shall run concurrently.

If this decision becomes FINRA's final disciplinary action, the suspensions shall begin at the opening of business on April 7, 2014, and end at the close of business on April 6, 2016. The fine shall be due and payable if Sharp should reenter the securities industry.



Andrew H. Perkins
Hearing Officer

Copies to: Daniel G. Sharp (*via overnight courier and first-class mail*)
David F. Newman, Sr., Esq. (*via electronic and first-class mail*)
William A. St. Louis, Esq. (*via electronic mail*)
Jeffrey D. Pariser, Esq. (*via electronic mail*)