

NASD OFFICE OF HEARING OFFICERS

RECEIVED
MAY 27 A 9 39
COMMUNICATIONS SECTION

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

STEPHEN M. RHOADS
(CRD No. 3265781)

[REDACTED]

[REDACTED]

Respondent.

Disciplinary Proceeding
No. C10040116

Hearing Officer – DRP

DEFAULT DECISION

May 23, 2005

Respondent is barred from associating with any NASD member in any capacity for misusing customer funds, in violation of NASD Conduct Rule 2110, and for failing to respond to requests for information, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110.

Appearances

Soo H. Im, Esq., New York, NY (Rory C. Flynn, Esq., Washington, DC, Of Counsel), for Complainant.

No appearance by or for Stephen M. Rhoads.

DECISION

I. Background

On December 9, 2004, the Department of Enforcement filed a two-count Complaint in this proceeding, attached to this Decision as Exhibit A. The Complaint alleges that Respondent Stephen M. Rhoads (Rhoads or Respondent) misused customer funds, in violation of NASD

011017147 05
000095153 2011

Conduct Rule 2110, and failed to respond to requests for information, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110.

Respondent did not file an Answer to the Complaint. Accordingly, on February 24, 2005, Enforcement filed a Motion for Entry of Default Decision, supported by the declaration of Soo H. Im and 22 exhibits. Respondent did not file a response to the motion.

For the reasons set forth below, Enforcement's motion is granted.¹

II. Respondent's Default

On December 8, 2004, Enforcement served the Complaint and Notice of Complaint on Respondent by certified and first class mail, sent to his current residential address, as reflected in the Central Registration Depository (the CRD Address), as well as two possible alternate addresses. The return receipt for the certified mailing to the CRD Address was returned, bearing the signature "S. Rhoads." (Im Declaration; CX-1; CX-3; CX-4; CX-5.)

Respondent did not file an Answer, but he submitted a letter dated December 27, 2004, to the NASD Office of Hearing Officers regarding a change of address. Respondent provided an address in Brooklyn, NY (the Brooklyn Address) and requested that no additional correspondence be sent to the CRD Address, or any other addresses.² Enforcement advised Respondent, via letter dated January 6, 2005, sent by first class and certified mail to his CRD Address and Brooklyn Address, that he needed to update his address history with CRD in order to stop receiving correspondence at that address. (Im Declaration; CX-9; CX-10; CX-11.)

¹ The factual determinations in this Decision are based on the allegations of the attached Complaint, which are deemed admitted, and the declaration and exhibits filed by Enforcement with its motion.

² Respondent stated that he was also notifying Enforcement that all correspondence should be sent to the Brooklyn Address.

On January 6, 2005, Enforcement served the Complaint and Second Notice of Complaint on Respondent by certified and first class mail sent to the CRD Address and the Brooklyn Address. The return receipt for the certified mailing to the CRD Address was returned, bearing the signature "S. Rhoads," and the one from the Brooklyn Address was signed for by "Sena." Again, Respondent failed to file an Answer or otherwise respond to the Complaint. (Im Declaration; CX-12; CX-13; CX-14.)

Enforcement complied with Procedural Rule 9134(b)(1) by mailing the Complaint and Notices of Complaint to Respondent's CRD address, thereby providing constructive notice of this proceeding. Moreover, he had actual notice of this proceeding, as evidenced by his letter and the signatures on the return receipt for each mailing. By failing to file an Answer or otherwise respond to the Complaint, Respondent defaulted. Pursuant to Rules 9215(f) and 9269(a)(2), the allegations in the Complaint are deemed admitted.

III. Jurisdiction

Respondent was registered with NASD member firm MML Investors Services, Inc. (MML), as an Investment Company Products/Variable Contracts Representative from March 30, 2000 to July 8, 2003.³ Since then, he has not been registered with any NASD member. Respondent is subject to NASD jurisdiction pursuant to Art. V, Section 4 of NASD's By-Laws, because the Complaint, which was filed within two years of Respondent's termination from MML, charges him with misconduct while he was registered with MML, and with failing to comply with requests for information made during the two-year period following termination of his registration.

³ CX-1.

IV. Findings of Fact and Conclusions of Law

A. Misuse of Customer Funds

The first cause of the Complaint alleges that Respondent misused public customer AC's funds. AC sought to purchase a Massachusetts Mutual Life Insurance Company (Mass Mutual) disability insurance policy for the period August 2002 to July 2003. The customer wanted to receive a lump sum discount by pre-paying the annual premium on the policy, and Respondent, who was an agent for Mass Mutual, instructed him to submit two checks, each made payable to Respondent. Accordingly, in August 2002, AC wrote one check to Respondent for \$324.72, and in September 2002, AC wrote a second check to Respondent for the balance of \$3,352.70. (Complaint ¶¶ 5, 6; Im Declaration; CX-16.)

Respondent deposited the checks in his own personal account and personally paid the initial premium with a cashier's check. Respondent also set up a Pre-Authorized Check Premium Payment Service (PAC) to arrange for automatic monthly withdrawals from Respondent's account to pay the premium on AC's policy. AC was unaware of this arrangement and had not consented to it. (Complaint ¶¶ 7, 8; Im Declaration; CX-15; CX-16.)

Respondent's account had insufficient funds with which to make the monthly premium payments. Mass Mutual thus sent AC a letter dated November 7, 2002, informing him that the policy was only paid through September 12, 2002 and that a payment of \$974.16 would bring the policy current and keep it from lapsing. AC's wife immediately submitted the payment, because she was unaware that AC had already paid the entire annual premium. (Complaint ¶ 9; Im Declaration; CX-16.)

Respondent's account continued to have insufficient funds to make the automatic premium payments on AC's account. Consequently, Mass Mutual informed AC on April 28, 2003 that his disability policy had lapsed as of April 15, 2003, due to non-payment. (Complaint ¶ 10; Im Declaration; CX-15; CX-16.)

Improper use of a customer's funds occurs when the funds are not used as intended by the customer,⁴ and is "patently antithetical" to the standards and principles that NASD seeks to promote through Rule 2110.⁵ These allegations, which are deemed admitted, are thus sufficient to establish for purposes of this default decision that Respondent misused the customer's funds. Accordingly, Rhoads violated NASD Conduct Rule 2110, as alleged in the first cause of the Complaint.

B. Failure to Respond to Staff Requests for Information

The second cause of the Complaint alleges that Respondent failed to respond to the staff's requests for information made pursuant to NASD Procedural Rule 8210. On September 2, 2003, October 6, 2003, November 6, 2003, January 24, 2004 and February 20, 2004, the staff sent letters to Respondent, requesting that he provide information and documents concerning his dealings with customer AC. The requests were made pursuant to Rule 8210. The staff sent all five letters by regular mail to Respondent at his CRD address. The staff also sent the November, January and February letters to a possible North Carolina address. Respondent did not respond in any manner to any of the requests, nor were the letters returned. On April 6, 2004, the staff sent another letter to Respondent, again requesting that he provide information and documents

⁴ *In re Bernard D. Gorniak*, Exchange Act Release No. 35,996, 1995 SEC LEXIS 1820 (1995) (respondent violated Rule 2110 when he accepted customer funds and failed to make timely investments with the funds as instructed and failed to promptly return the funds).

⁵ *Dist. Bus. Conduct Comm. v. Shegon*, No. C9A960030, 1997 NASD Discip. LEXIS 66, at *5 (NBCC Nov. 20, 1997) (quoting *Wheaton D. Blanchard*, 1976 SEC LEXIS 1571, at *2 (May 27, 1976)).

concerning AC, pursuant to Rule 8210. The letter was sent via certified and first class mail to the CRD Address, as well as to the North Carolina address and a possible New York address. The return receipt for the certified mailing to the CRD Address was returned, bearing the signature, "Carter Rhoads." Respondent did not respond in any manner to this letter. (Complaint ¶¶ 14 – 25; Im Declaration; CX-17; CX-18; CX-19; CX-20; CX-21; CX-22.)

The staff served the requests in accordance with Rule 8210(d), and pursuant to that rule Respondent is deemed to have received them.⁶

Procedural Rule 8210 authorizes NASD to require any person subject to its jurisdiction to provide information related to any matter under investigation. The rule serves as a key element in NASD's oversight function and allows NASD to carry out its regulatory functions without subpoena power.⁷

The allegations in the Complaint, which are deemed admitted, are sufficient to establish for purposes of this default decision that Respondent failed to respond to the staff's requests for information, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110, as charged in the second cause of the Complaint.

⁶ See also *David I. Cassuto*, Exchange Act Release No. 48,087, 2003 SEC LEXIS 1496, at *9 (June 25, 2003).

⁷ See, e.g., *Dep't of Enforcement v. Valentino*, No. FP1010004, 2003 NASD Discip. LEXIS 15, at *12 (N.A.C. May 21, 2003), *aff'd*, 2004 SEC LEXIS 330 (Feb. 13, 2004) ("It is well established that because NASD lacks subpoena power over its members, a failure to provide information fully and promptly undermines NASD's ability to carry out its regulatory mandate.") (citation omitted); *Joseph G. Chiulli*, Exchange Act Release No. 42,359, 2000 SEC LEXIS 112, at *16 (Jan. 28, 2000) (noting that Rule 8210 provides a means for the NASD effectively to conduct its investigations, and emphasizing that NASD members and associated persons must fully cooperate with requests for information).

V. Sanctions

For improper use of customer funds, NASD Sanction Guidelines recommend a fine of \$2,500 to \$50,000, and advise adjudicators to consider a bar absent mitigating factors, such as evidence of a misunderstanding regarding the customer's intentions.⁸ Here, there is no evidence of a misunderstanding or other mitigating factors that would warrant a lesser sanction. Indeed, the circumstances support the conclusion that Rhoads, who deposited the customer's checks in his account, knowingly acted contrary to his customer's wishes. Moreover, his actions resulted in a financial loss to the customer, when his wife paid \$974.16 to the insurance company after being informed that the policy would lapse. Respondent's misconduct also left the customer vulnerable to risk when the disability insurance policy was canceled.

Enforcement seeks a bar, and for the reasons stated above, the Hearing Officer finds there are no mitigating factors that justify a sanction less than a bar. Accordingly, a bar is imposed for this violation.⁹

For failing to respond to requests for information made pursuant to NASD Procedural Rule 8210, the Guidelines recommend the imposition of a bar unless mitigating circumstances exist.¹⁰ Once again, the record discloses no mitigating factors. Therefore, Rhoads is also barred for this violation.

⁸ *NASD Sanction Guidelines* at 38 (2005 ed.).

⁹ Enforcement does not seek restitution, because Respondent paid \$2,703.26 to reimburse AC for missing premiums. Motion at 5, n. 1.

¹⁰ *Guidelines* at 35.

VI. Conclusion

Respondent Stephen M. Rhoads is barred from associating with any NASD member firm in any capacity for misusing customer funds, in violation of NASD Conduct Rule 2110, and for failing to respond to requests for information, in violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110. The bars are effective immediately if this Decision becomes the final disciplinary action of NASD.

SO ORDERED.


Dana R. Pisanelli
Hearing Officer

Dated: May 23, 2005
Washington, DC

Copies to: Stephen M. Rhoads (*via overnight and first class mail*)
Soo H. Im, Esq. (*via electronic and first class mail*)
Rory C. Flynn, Esq. (*via electronic and first class mail*)

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

**STEPHEN M. RHOADS
(CRD No. 3265781),**

Respondent.

**Disciplinary Proceeding
No. C10040116**

Hearing Officer

COMPLAINT

Upon information and belief, the Department of Enforcement alleges that:

JURISDICTION

1. Respondent Stephen M. Rhoads ("Respondent") first became registered with NASD as an Investment Company Products/Variable Contracts Representative on March 30, 2000 through member firm, MML Investors Services, Inc. (BD No. 10409) ("MML Investors").
2. Respondent is not currently registered with NASD. On July 8, 2003, MML Investors electronically filed with NASD a Uniform Termination Notice for Securities Industry Registration ("Form U-5") concerning Respondent. The Form U-5 indicated that Respondent's last day of employment at MML Investors was July 1, 2003 and that he had been terminated by the firm for violating firm policy by depositing customer funds into his own account.
3. Respondent therefore remains subject to the jurisdiction of NASD pursuant to Article V, Section 4 of NASD's By-Laws.

FIRST CAUSE OF COMPLAINT
(Misuse of Funds Belonging to AC)
(Violation of NASD Conduct Rule 2110)

4. Paragraphs 1 through 3 are re-alleged and incorporated herein by reference.
5. Customer AC wanted to purchase a disability insurance policy from the Massachusetts Mutual Life Insurance Company ("Mass Mutual") through Respondent, an agent of Mass Mutual. AC planned to pay the annual premium – covering the period from August 2002 to July 2003 - in a lump sum in order to receive a discount. He was instructed by Respondent to make the two checks payable to Respondent.
6. In or about August 2002, customer AC wrote a check, payable to Respondent, in the amount of \$324.72 to be applied to the premium for AC's disability insurance policy. In or about September 2002, AC wrote a check, payable to Respondent, in the amount of \$3,352.70 to pay the remaining balance of the annual premium for AC's disability insurance policy.
7. Respondent deposited these funds into his own personal account and personally paid for the initial premium for AC's disability policy by sending a cashier's check to new business drawn on his personal account.
8. Respondent also set up a Pre-Authorized Check Premium Payment Service ("PAC") whereby automatic monthly withdrawals would be made to pay the remaining premiums for AC's policy from his own personal account. This account belonged to Respondent and he set it up without AC's knowledge, authorization or consent.

9. From approximately September 2002 to February 2003, the PAC made monthly automatic premium payments for AC's disability policy. However, because there were insufficient funds in the account from which the PAC withdrew the payments, the automatic payments discontinued, and by letter dated November 7, 2002, Mass Mutual informed AC that the disability policy was paid up through September 12, 2002, and that a payment of \$974.16 was needed to bring the policy current and keep the disability policy from lapsing. Unaware that AC had already made a payment for the entire annual premium, on or about November 21, 2002, AC's wife sent a payment to Mass Mutual for \$974.16 to prevent the policy from lapsing.
10. Subsequently, several more drafts from the PAC were returned for insufficient funds in the account. As a result, Mass Mutual informed AC that his disability policy had lapsed as of April 15, 2003 due to non-payment.
11. The PAC withdrawals that were applied to AC's disability policy only totaled approximately one-third of the total amount of the premium for AC's disability policy - \$3,677.42 (\$324.72 + \$3,352.70).
12. Respondent did not apply AC's funds as the customer directed and/or intended and therefore, Respondent misused AC's funds.

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

SECOND CAUSE OF COMPLAINT

(Failure to Respond)

(Violation of NASD Procedural Rule 8210 and NASD Conduct Rule 2110)

13. Paragraphs 1 through 12 are re-alleged and incorporated herein by reference.

First and Second Requests

14. By letters dated September 2, 2003 and October 6, 2003, the staff of the NASD (the "Staff") requested that Respondent provide information concerning, among other things, checks that Respondent received from AC. The requests were made pursuant to, and in accordance with, NASD Conduct Rule 8210, and required responses by September 17, 2003, and October 21, 2003, respectively.

15. The letters were sent via regular mail to Respondent's current residential address as reflected in the records of the NASD Central Registration Depository, [REDACTED] [REDACTED] (the "CRD Address"). The letters were not returned.

16. The Staff did not receive a response from Respondent.

Third Request

17. By letter dated November 6, 2003, the Staff requested that Respondent provide information and documents concerning, among other things, checks that Respondent received from AC. The letter was sent via regular mail to the CRD Address, as well as an additional address for Respondent obtained by the Staff: [REDACTED] (the "NC Address"). This request was made pursuant to, and in accordance with, NASD Conduct Rule 8210, and required a response by November 21, 2003. The letter was not returned.

18. The Staff did not receive a response from Respondent.

Fourth Request

19. By letter dated January 24, 2004, the Staff again requested that Respondent provide information and documents concerning, among other things, checks that Respondent received from AC. The letter was sent via regular mail to the CRD and the NC Addresses. This request was made pursuant to, and in accordance with, NASD Conduct Rule 8210, and required a response by February 9, 2004. The letter was not returned.

20. The Staff did not receive a response from Respondent.

Fifth Request

21. By letter dated February 20, 2004, the Staff again requested that Respondent provide information and documents concerning, among other things, checks that Respondent received from AC. The letter was sent via regular mail to the CRD and the NC Addresses. This request was made pursuant to, and in accordance with, NASD Conduct Rule 8210, and required a response by March 8, 2004. The letter was not returned.

22. The Staff did not receive a response from Respondent.

Sixth Request

23. By letter dated April 6, 2004, the Staff once again requested that Respondent provide information and documents concerning, among other things, checks that Respondent received from AC. The letter was sent via certified mail, return receipt requested and regular mail to the CRD and the NC Addresses, as well as the following additional address: [REDACTED]

This request was made pursuant to, and in accordance with, NASD Conduct Rule

8210, and required a response by April 16, 2004. The letter also stated that the failure to comply with the request could subject Respondent to disciplinary action.

24. The return receipt for the certified mailing to the CRD Address was returned by USPS, with handwriting indicating that the certified mailing was delivered on April 10, 2004 and signed for by "Carter Rhoads."

25. The Staff did not receive a response from Respondent.

By reason of the foregoing, Respondent violated NASD Procedural Rule 8210 and NASD Conduct Rule 2110.

PRAYER FOR RELIEF

WHEREFORE, Complainant respectfully requests:

- A. Findings of fact and conclusions of law that Respondent committed the violations charged and alleged herein;
- B. An order imposing sanctions upon Respondent in accordance with NASD Procedural Rule 8310;
- C. An order requiring Respondent to disgorge fully any and all ill-gotten gains and/or make full and complete restitution, together with interest;
- D. An order imposing such costs of any proceedings as are deemed fair and appropriate under the circumstances in accordance with NASD Procedural Rule 8330; and
- E. An order imposing any other fitting sanction.

Dated: December 8, 2004

DEPARTMENT OF ENFORCEMENT



Soo H. Im
Regional Attorney
NASD
District 10
One Liberty Plaza
New York NY 10006

Of Counsel:

David M. Jaffe
Regional Chief Counsel
Department of Enforcement, District 10
NASD
One Liberty Plaza
New York, NY 10006

Rory C. Flynn
Chief Litigation Counsel
Department of Enforcement
NASD
1801 K Street, N.W., Suite 800
Washington, D.C. 20006