BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Enforcement, Complainant, vs. Respondent	**Amended Decision** Complaint No. C07010037 May 13, 2003

Hearing Panel dismissed complaint and found respondent registered representative not liable for unsuitable recommendations to five customers to switch from certain mutual funds to others having similar investment objectives. Held, affirm dismissal.

Appearances:

For the Complainant Department of Enforcement: NASD Regional Counsel
For the Respondent: Respondent, pro se

Decision

We called this decision for review pursuant to NASD Procedural Rule 9312 to examine the findings and the Hearing Panel's legal standard for determining suitability. After a review of the record in this matter, we affirm the Hearing Panel's dismissal of the complaint and find that the Respondent's recommendations to five customers to switch from certain mutual funds to other mutual funds that had similar investment objectives were suitable.

I. Background and Procedural History

Respondent entered the securities industry as an investment company and variable contracts products representative and direct participation programs representative. At all times relevant to the complaint, he was registered with NASD through Firm A, now known as Firm B. Respondent currently is registered with another member firm.

In 2001, the Department of Enforcement ("Enforcement") filed the one-cause complaint in this matter,[1] alleging that from December 1993 through March 1996, Respondent violated Conduct Rules 2310 and 2110 by making unsuitable recommendations to five customers to liquidate certain mutual funds they owned and use the proceeds from those sales to purchase other mutual funds.

II. Facts

Many of the facts are undisputed. Respondent was an investment company and variable contracts products representative of Firm A from 1993 to 1996when, he admits, he recommended the transactions at issue to five of his customers. Each transaction involved movement of the customer's money between mutual funds that had similar investment objectives. The transactions were not initiated because of any changes in the customers' investment objectives.

A. The Funds

All of the funds that Respondent recommended had similar investment objectives. All of them were also equity funds, and most were growth funds focusing on "emerging growth companies." The prospectuses described the funds as follows:

1) IDEX II Growth Fund (A) ("IDEX") is an open-end diversified management investment company. Its investment objective is growth. The fund invests primarily in equity securities listed on a national securities exchange or on the Nasdaq Stock Market. A variable front-end load sales charge is applicable to all purchases. The IDEX II Growth Fund was formed through the merger of The IDEX Fund and IDEX Fund 3 in 1996.

2) Pioneer Small Company Fund (A & B) ("Pioneer SCF") is an open-end investment company seeking capital appreciation by investing in a diversified portfolio. The fund invests at least 65 percent of its total assets in common stocks and common stock equivalents of companies with a market capitalization of less than $1 billion. The A fund is a front-end loaded fund with a 5.75 percent sales charge with break points at $50,000, $100,000, $250,000, $500,000 and $1,000,000. The B fund is a back-end loaded fund with a 4 percent declining deferred sales charge which is eliminated after 6 years.

3) Pioneer Micro Cap Fund (B) ("Pioneer MCF") is an open-end fund that primarily invests in common stocks of micro-cap companies with market values of $500 million or less. It invests at least 80 percent of its total assets in these securities. The B fund is a back-

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[1] The complaint resulted from an NASD investigation of Respondent following his 1996 discharge from Firm A for violating company procedures by using hypotheticals in the presentation of variable life products. During the course of that investigation, Firm A presented NASD staff with two customer complaints, which indicated that Respondent allegedly engaged in a pattern of excessive mutual fund switches. Upon further investigation, Enforcement staff expanded that review to the accounts of the five customers at issue in this proceeding.

end loaded fund with a 4 percent declining deferred sales charge which is eliminated after 6 years.

4) Putnam Capital Appreciation Fund (B) ("Putnam") is an open-end investment company seeking capital appreciation. The fund invests at least 65 percent of its total assets in common stocks. The B fund is a back-end loaded fund with a 5 percent declining deferred sales charge which is eliminated after 6 years.

5) Vista Capital Growth Fund (A) ("Vista") is an open-end investment company seeking long-term capital growth. It invests at least 80 percent of its total assets in common stocks. It purchases shares of another investment company with an identical investment objective. The A fund is a front-end loaded fund with a 4.75 percent sales charge with break points at $100,000, $250,000, $500,000, $1,000,000 and $2.5 million.

6) Govett Smaller Companies Fund (A) ("Govett") is an open-end fund that seeks long-term capital appreciation by investing primarily in equity securities that it believes will be future industry leaders, which are the size of companies listed on the NASDAQ Composite Index and which typically have individual market capitalizations of less than $1 billion. Under normal market conditions the fund expects to invest 80 percent of its total assets in common stocks. The A fund is a front-end loaded fund with a 4.95 percent sales charge with break points at $100,000, $250,000, $500,000, and $1,000,000.

7) John Hancock Special Equities Fund (B) ("John Hancock") is an open-end investment company organized in 1984. It seeks growth through investing in a diversified portfolio of "special situation" equity securities of emerging growth companies. It invests at least 65 percent of its total assets in these "Special Equities." The B fund is a back-end loaded fund with a 5 percent sales charge if the investment is sold within the first year, followed by annually declining percentages such that after holding the investment for 6 years the sales charge is eliminated.

8) Oppenheimer Main St. Income & Growth Fund (A & B) ("Oppenheimer") is an open-end fund that seeks total return from current income and capital appreciation. It mainly invests in U.S. companies with varied capitalizations, but focuses on large capitalization firms. The A fund is a front-end loaded fund with a 5.75 percent sales charge with break points at $25,000, $50,000, $100,000, $250,000, $500,000, and $1,000,000. The B fund is a back-end loaded fund with a 5 percent declining deferred sales charge, which is eliminated after 6 years.

9) MFS Emerging Growth Fund (B) ("MFS") is an open-end fund that seeks long-term growth of capital and invests at least 65 percent of its total assets in common stocks of emerging growth companies. The B fund is a back-end loaded fund with a 4 percent declining deferred sales charge which is eliminated after 6 years.

B. The Customers and the Switches

The transactions that occurred in the five subject customer accounts are described below in narrative form and summarized in tabular form in Exhibit A to this decision.

1) KC's Account

KC, who was 52, was the only customer who testified in this proceeding. He was once the general manager of an agricultural company. Since that company closed, he has been unemployed. His investment objective is long-term growth. In 1981 or 1982, KC opened an IRA account with Firm A as a rollover account from a 401(k) account that he had established with a former employer. At that time, Respondent was not KC's account executive. Respondent was assigned to KC's account in 1989 or 1990. KC's original mutual fund investment was made in IDEX in March 1988 and February 1991. In 1993, KC's IDEX investment had grown to approximately $92,000. In November 1993, Respondent recommended that KC sell IDEX and purchase shares of Vista. Enforcement did not allege that this initial switch from the IDEX fund to Vista was unsuitable.[2]

KC testified that prior to the execution of each of the transactions at issue, he and Respondent discussed the recommended switch. KC testified that if Respondent recommended a switch,

> [H]e had to have a reason for me to change it [the current fund], and we had – we looked at charts and what have you, you know, where it had been – like you look up on the internet where they have got graphs of different growths, and the fund I was in wasn't growing as good [sic] as this one was growing on the chart and just felt like I would be better off to move it, I would be better off, so I signed to move it or o.k. to move or whatever was required at that time.

KC stated that Respondent would "[lay] it on the table," and KC could either go with Respondent's recommendation or "try to wing it" on his own. KC also testified that he always asked Respondent "what it's gon' [sic] cost [him]" to make any recommended investment changes. KC stated that he usually followed Respondent's recommendations, but he testified that

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2 At the oral argument, Enforcement stated that Respondent's initial recommendations to all five customers to switch out of the IDEX fund were not included in the alleged unsuitable recommendations because the customers had held the IDEX fund for a substantial period of time. Enforcement argued therefore that it was presumably "reasonable" for Respondent to have recommended a change at that time. Enforcement also stated, however, that it did not include the time that each customer had held IDEX in its analysis of the accounts and its calculation of the number of switches that had occurred. We note that if the IDEX holdings had been included, each account would have held the funds for a longer period, and therefore the number of switches would have been proportionately lower.

he did reject one recommended switch for reasons that he could not recall. KC also testified that he believed that Respondent had always acted "in KC's best interest."[3]

a) First Alleged Unsuitable Switch

The complaint alleges that in February 1995 (15 months after the purchase of Vista), Respondent made an unsuitable recommendation to KC to sell Vista and buy Putnam. At the time of this recommendation, KC's investment in Vista amounted to $89,767.07, reflecting a loss of almost $3,000 (including the estimated $4,386.05 he paid in a front-end sales charge when he purchased Vista). Respondent told KC that Vista was not performing well, and he thought Putnam would achieve greater returns. KC testified that he and Respondent had discussed the merits of the recommendation, including the costs that would be associated with it. KC stated that Respondent had told him that the higher returns from the new fund would compensate for the cost of the switch. Respondent testified that he had recommended Putnam because he thought it would be a good investment and he had learned that it had lately become available for purchase, on a limited basis, to non-employees of Putnam. KC followed Respondent's recommendation and purchased Putnam.

In January 1996, 11 months after purchasing the shares, KC's investment in Putnam had grown to $114,934.33. Respondent earned a commission of $1,795.34 on KC's purchase of Putnam. There were no front-end charges associated with the Putnam purchase.

b) Second Alleged Unsuitable Switch

Eleven months later, in January 1996, Respondent recommended that KC sell his shares in Putnam and buy Pioneer SCF. Respondent testified that he made this recommendation because certain events had occurred that caused him to become concerned about Putnam's ability to handle its back office operations. Respondent stated that on one occasion Putnam had erroneously created a Form 1099 for a tax-free account for one of his clients. On another occasion in November 1995, Putnam made a large distribution check payable to Respondent, instead of to the order of the customer. When Respondent contacted Putnam staff about this check, Putnam staff advised him to deposit it in his account, and then write out a personal check to the client. KC paid a $4,487.96 back-end charge on the sale of the Putnam shares and Respondent received a $2,208.72 commission on the purchase of Pioneer SCF.

By October 1996, nine months later, KC's investment in Pioneer SCF had grown to approximately $132,000. At this time, Respondent recommended that KC sell Pioneer SCF and buy Pioneer Cash Reserves Fund, a money market fund. Respondent testified that he was

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[3] This testimony is consistent with a letter in the record dated March 4, 1998, which indicates that Respondent "invested his time [with KC]" and that KC was pleased with Respondent's work. Although KC stated that he may have felt a little pressure from Respondent to sign the March 4, 1998 letter, he nonetheless testified that he always had discussions with Respondent about the transactions in his account and that Respondent was always "trying to help [KC]."

concerned about his research, which indicated that, historically, the stock market typically declines after a Presidential election. Accordingly, he advised KC to take his gains and move to Pioneer Cash Reserves Fund.[4] Respondent did not receive a commission on this switch, KC paid no sales charge on it, and the complaint does not allege this switch to be unsuitable.

c) Third Alleged Unsuitable Switch

One month later, in November 1996, KC's money was switched from Pioneer Cash Reserves Fund to Fidelity Cash Reserves Fund, another money market fund. KC paid a $4,417.45 back-end sales charge when he sold Pioneer Cash Reserves Fund. KC's account was then worth $127,678.57. Respondent did not receive a commission on this switch and he testified that he did not recall the precise circumstances for recommending this switch.

d) Fourth Alleged Unsuitable Switch

KC testified that in late 1996 or early 1997, he became concerned that the stock market had been making gains while his investment remained in money market funds and that he telephoned Respondent to ask whether the money should be moved. Respondent first advised KC "to sit tight." In March 1997, however, Respondent recommended that KC get back into the market by buying Pioneer MCF. At the time of the purchase of Pioneer MCF, KC's account was worth $129,200.00. Respondent received a commission of $2,574.00 on the purchase of Pioneer MCF.[5]

2) EB's Account

EB did not testify in this proceeding. He is a farmer and a longstanding client of Respondent's whose investment objective is long-term growth.[6] The NASD examiner testified that he had one phone conversation with EB, in which EB stated that Respondent had "always disclosed" the sales charges. EB subsequently wrote the examiner a letter dated February 13, 1998, stating that he (EB) was "satisfied" with Respondent's services, that Respondent "[had] always taken time to tell [him] why he [Respondent] has recommended things," and when fees

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[4] The record shows that, in fact, the stock market increased following the Presidential election of November 1996.

[5] At the hearing below, Enforcement had argued that if KC had remained in Pioneer Cash Reserves Fund until he purchased Pioneer MCF, he would not have incurred a sales charge when he sold Pioneer Cash Reserves Fund. A post-hearing submission to the record clarified, however, that the prospectus in effect at the time KC purchased Pioneer MCF provided that a new account could not be opened by exchanging shares from any other Pioneer mutual fund. As a result, KC would have had to pay a back-end sales charge even if he had switched directly from Pioneer Cash Reserves Fund to Pioneer MCF.

[6] EB was still a client of Respondent's as of the date of the oral argument.

would be charged. EB also stated that he did not want to talk with the examiner any further about the matter.

a) Alleged Unsuitable Switches

The complaint alleges four unsuitable switches in EB's account from December 1993 to February 1997. Except for minor differences in two dates, the first three switches are otherwise identical to those described above that were alleged to be unsuitable in KC's account. In December 1993, EB's account was invested in IDEX. On Respondent's recommendation, EB switched his entire account to Vista.[7] Fourteen months later, in February 1995, Respondent recommended that EB sell Vista and buy Putnam, for the same reasons Respondent had recommended that KC switch to Putnam. EB followed the recommendation and Respondent received a $1,354.53 commission on the transaction. EB did not pay any sales charges at that time because the Putnam fund in which he invested sold him Class B mutual fund shares.

In January 1996, 11 months later, EB followed Respondent's recommendation to sell Putnam and purchase Pioneer SCF. Respondent testified that he had made this recommendation to EB based on the same concerns that he had enunciated to KC regarding the problems with Putnam's back office operations. EB paid a back-end load of $3,432.85 on the sale of Putnam and Respondent received a commission of $1,666.13 on the purchase of Pioneer SCF.

Nine months later, in October 1996, on Respondent's recommendation, EB switched his entire investment out of Pioneer SCF into the Pioneer Cash Reserves Fund. Again, Respondent made this recommendation due to his belief that stock markets historically decline following a Presidential election. Enforcement did not allege that this transaction was unsuitable.

One month later, in November 1996, Respondent recommended that EB switch from the Pioneer money market fund to the Fidelity money market fund. Respondent could not recall the precise reasons for this recommendation. EB followed Respondent's recommendation, and EB paid a back-end load of $3,369.76 on the Pioneer investment.

The fourth alleged unsuitable switch in EB's account occurred three months later, in February 1997. This switch differs from the fourth in KC's account only to the extent that instead of switching to Pioneer MCF, EB invested half of his funds from Fidelity Cash Reserves Fund in John Hancock and half in MFS. Respondent received commissions on these purchases of $1,355.68 and $1,936.68, respectively.

3) HC's Account

HC did not testify in this proceeding. The NASD examiner had several telephone conversations with HC, but he declined all offers to participate. The record shows that he is a pharmacist who resides in Southern Georgia and his investment objective is long-term growth.

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[7] Again, Enforcement did not allege that the initial switch from IDEX to Vista was unsuitable.

Respondent testified that HC also had investments in real estate, real estate limited partnerships, various businesses, and a number of mutual funds. On March 27, 1997, HC filed a written complaint with Firm A about Respondent's recommendations to "move [HC's] funds from one commission earning investment to another." HC speculated that these recommendations were made to "feather [Respondent's] own pocket."

The evidence does not show when HC became a client of Respondent's. The complaint alleges that HC invested an unspecified amount of money in IDEX at some unspecified time, and then switched to Vista in March 1994. According to an attachment to HC's letter of complaint to Firm A, his investment in Vista in March 1994 was $299,324.99.

The complaint alleges two unsuitable switches in HC's account. Both switches are identical to those alleged in KC's account and are substantially similar to those in EB's account. Respondent testified that his reasons for recommending the switches to HC were the same as the reasons set forth above for his recommended switches to KC and EB.

The first allegedly unsuitable transaction is the switch from Vista to Putnam in February 1995, which occurred 11 months after HC acquired Vista. Respondent did not receive a commission on HC's sale of Vista or his purchase of Putnam.

The second switch occurred in January 1996, 11 months after HC purchased Putnam. HC followed Respondent's recommendation and sold Putnam and purchased Pioneer SCF, thereby incurring both a back-end sales charge of $15,456.43 on the sale of Putnam, and a front-end sales charge of $9,442.24 on the purchase of Pioneer SCF. Respondent earned a commission of $6,182.72 on the sale of Putnam and received a commission of $4,699.19 on the purchase of Pioneer SCF. During 1996, the returns earned by Pioneer SCF were less than those earned by Putnam. By the end of January 1997, however, the value of HC's investment had grown to $469,952.93.

4) DM's Account

In 1992, DM was referred to Respondent by a friend. Prior to his association with Respondent, DM, a nurse anesthetist, had never purchased mutual funds or stocks. His investment objective is long-term growth. In 1993, DM opened an IRA account with Respondent and invested in IDEX. In March 1994, DM sold IDEX and purchased Oppenheimer.[8] DM paid a front-end sales charge of $1,163.20 to acquire Oppenheimer.

DM did not testify in this proceeding. The record does, however, include a declaration signed by DM, dated May 4, 1998, that was admitted into evidence. In his declaration, DM stated that after he had received information from Firm A that it had terminated Respondent, he became concerned about the switches that Respondent had recommended to him. He also stated that Respondent had not discussed the fees and charges associated with those switches. At the

[8] Again, Enforcement did not allege that the initial switch, this time from IDEX to Oppenheimer, was unsuitable.

hearing below, however, Respondent testified that he had discussed the costs of all transactions with DM prior to their execution. Additionally, the record contains a memorandum dated November 18, 1997, which the NASD examiner testified that he prepared after a telephone conversation with DM. In this memorandum, the examiner wrote that DM told him that "[Respondent] always stated that it would cost [DM] 5 percent in charges to move [funds]."

The complaint alleges two unsuitable switches in DM's account. The first is a switch in May 1995 from Oppenheimer to Govett. DM had held the Oppenheimer fund for 15 months prior to this transaction, and the account was worth $20,237.13. DM paid a front-end load of $2,126.50 on the purchase of Govett, and Respondent received a commission of $912.89. Respondent testified that he had recommended this switch because there was a controversy involving Oppenheimer's fund manager (which ultimately led to his termination), and he was fearful that the fund would not operate as successfully under a newly hired manager. DM received a 68.99% return with Govett in 1995, while Oppenheimer showed only a 15.70% return.

In November 1995, six months after switching to Govett, DM's account was worth $55,880.75. At that time, Respondent recommended that DM switch to Pioneer SCF because the fund manager for Govett, whom Respondent particularly admired, had resigned. Enforcement countered that Respondent's assertion about his fondness for the former manager at Govett was not credible because that manager had moved on to form his own fund, yet Respondent did not choose to follow that manager by placing DM's monies there. Respondent responded that he did not believe that the former Govett manager's new fund was entirely operable, and that he therefore thought at that time that DM's money would be better invested in another fund that had an operating history, such as Pioneer SCF. DM paid a front-end sales charge of $2,514.63 on the purchase of Pioneer SCF, and Respondent earned a commission of $1,257.31. In 1996, the Govett fund lost 10.58%, while Pioneer SCF gained 24.15%. In late January and early February 1997, DM redeemed his shares of Pioneer SCF and moved his investments to another broker. There is no evidence of the value of DM's account at that time.

5) SB's Account

SB did not testify in this proceeding. The NASD examiner testified that he had one telephone conversation with SB, in which she did not confirm or deny whether Respondent had discussed sales charges or fees with her, but that she "certainly indicated that they [sales charges or fees] very well may have been [discussed], and she simply followed [Respondent's] advice whenever he recommended a new fund for her." SB did not return the examiner's subsequent telephone calls.

SB's investment objective is long-term growth. In 1987, SB invested $13,254.93 in IDEX. She held that position for seven years until, in March 1994, Respondent recommended that she switch her investment, then worth $31,398.85, to Oppenheimer. She paid a front-end sales charge of $1,726.52, and Respondent received a commission of $745.54. That switch is not alleged to have been unsuitable.

The complaint alleges two unsuitable switches in SB's account. The first is a switch from Oppenheimer, in February 1995, 11 months after its purchase, to Putnam. At the time, the value of SB's investment in Oppenheimer was $29,013.52. There was no sales charge on the purchase; however, Respondent received a commission of $580.07. As with DM, Respondent testified that he recommended the switch away from Oppenheimer to SB because of the controversy surrounding that company's fund manager. In 1995, Putnam had a rate of return of 33.38%, compared to a 30.77% return for Oppenheimer.

In March 1996, one year after switching to Putnam, SB's account was worth $38,515.33. As with his other customers, Respondent testified that he became concerned about Putnam's back-office operations and he recommended that SB switch to Pioneer SCF. SB paid a back-end sales charge of $1,159.82 on the sale of Putnam, reducing her account value to $37,355.51. Respondent received a commission on the purchase of Pioneer SCF of $746.91. In June 1997, SB sold Pioneer SCF, a transaction not at issue in this proceeding. Her account at that time was worth $50,350.16.

III. Discussion

A. A Pattern of Mutual Fund Trading Creates the Presumption of Unsuitable Recommendations

It has long been established that a pattern of mutual fund switching is presumptively violative of NASD rules. In a statement of policy issued under Conduct Rule 2310, NASD's Board of Governors established that trading in mutual fund shares, particularly on a short-term basis,[9] violates a salesperson's responsibility for fair dealing. IM-2310-2(b)(3). The Board further pointed out that "normally [such funds] are not proper trading vehicles and such activity on its face may raise the question of Rule violation." Kenneth C. Krull, 53 S.E.C. 1101, 1104 (1998), aff'd Krull v SEC, 248 F.3d 907 (9th Cir. 2001).

The Commission has articulated the presumption against mutual fund switching as follows:

> 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 involves new sales loads. . . [W]here . . . a pattern of similar switching transactions in

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[9] NASD and the Commission have not specifically defined "short term." The Commission's previous decisions, however, focus on periods of less than one year as short-term. See Krull v. SEC, 248 F.3d 907, 912 n.6 (9th Cir. 2001), citing Richard Hoffman and Kirk Montgomery, 2000 SEC LEXIS 105*, (2000) (referencing Winston H. Kinderdick, 46 S.E.C. 636 (1976), wherein the Commission noted examples of multiple switches in one year without explicitly stating the holding periods). See also Russell L. Irish, 42 S.E.C. 735 (1965), aff'd, 367 F.2d 637 (9th Cir. 1966) (noting greatest percentage of switches had holding periods of less than one year).

> fund shares is established, it is incumbent upon the person responsible to demonstrate the unusual circumstances which justified such a clear departure from the manner in which investments in mutual funds are normally made.

Krull, at 1105, citing Kinderdick, supra at 639 (emphasis in original) (footnote omitted). See also Terry Wayne White, 50 S.E.C. 211, 212-213(1990) (respondent did not attempt to defend the pattern of trading that SEC found to be unsuitable for any customer); Charles E. Marland & Co., 45 S.E.C. 632, 635-636 (1974) (pattern of switches in customer accounts justified presumption of unsuitable recommendations that respondent failed to rebut).

A pattern of mutual fund switches thus creates a rebuttable presumption of unsuitability. The person who recommended the transactions must produce evidence to show reasonable grounds for having made the switching recommendations. Once such a showing has been made, it is then up to Enforcement to discredit those grounds with its own evidence and cross-examination, such that the preponderance of the evidence shows that the switch was not based on reasonable grounds.

There is no bright line test for finding when a pattern of short-term mutual fund trading exists, based, for instance, on the number of trades or the holding periods for the funds. Instead, an adjudicator must consider not only the frequency of trading, but the totality of the circumstances in each case to determine if a pattern exists. In considering whether such a pattern occurred in this case, we have looked to the following factors: 1) 14 switches occurred in five customer accounts over a period of almost three and one-half years; 2) all of the switches occurred because of Respondent's recommendations; 3) all of the switches occurred without any changes in the customers' investment objectives; 4) all of the switches were made between funds with similar growth objectives; 5) most of the switches involved sales charges; and 6) the switches involved relatively short holding periods (from three months to two years).

Given the combination of these factors, we find that the record here does show that there was a pattern of short-term trading in the mutual fund shares in the accounts at issue, thereby giving rise to the presumption that the recommendations made by Respondent were unsuitable. At this point, we thus turn to the record to determine whether Respondent rebutted the presumption of unsuitability and demonstrated that he had reasonable grounds to believe that the recommendations at issue were suitable.

B. Respondent Offered Reasonable Grounds for His Recommendations

We find that Respondent had reasonable grounds for his recommendations to switch mutual funds in the five accounts at issue. In reaching this determination, we have analyzed the evidence with regard to each of the transactions described above and we have considered the standards that govern Respondent's suitability obligation.

Conduct Rule 2310 provides that in recommending a transaction to a customer, a registered representative "shall have reasonable grounds" for believing that the recommendation

is suitable. Further, in March 1994, NASD issued Notice to Members 94-16 to remind members of their suitability obligation with regard to mutual fund sales, which includes an evaluation of the net investment advantage of any recommended mutual fund switch. The Notice to Members specifically stated that members should consider whether the transaction fees would undermine the financial gain or investment objective to be achieved by the switch.

We find that Respondent had reasonable grounds for recommending the mutual fund switches at issue. In three instances (customers KC, EB, and HC), Respondent recommended the sale of a fund that was losing value (Vista) and the purchase of one that had increased its value and had just become open to public investors (Putnam). On four separate occasions (with SB and again with customers KC, EB, and HC), he was concerned when he received documents that led him to suspect that there were back-office problems with Putnam, so he recommended that those customers sell that fund and purchase Pioneer SCF. Respondent testified that in the fall of 1996, he relied on his research that indicated a historical downturn in the market after a Presidential election to recommend that KC and EB take their gains and switch into cash reserve funds. He further testified that in early 1997, when he was satisfied that the market was not experiencing such a downturn, he recommended that those customers switch back into equities. For KC and EB, the switch from Pioneer SCF to Pioneer Cash Reserves Fund was not alleged as unsuitable. It was the switch back from Fidelity Cash Reserves Fund to an equity fund that was alleged to be unsuitable. As to customers DM and SB, Respondent recommended that they sell Oppenheimer when he learned of a controversy surrounding that company's fund manager, which ultimately led to the manager's termination. Respondent's recommendations to customers were consistent.[10] In addition, none of Respondent's actions or recommendations undermined the reasonable grounds that he had for making his recommendations to his customers.

Finally, Respondent testified that he recommended that DM sell Govett and purchase Pioneer SCF when Respondent learned that Govett's fund manager, whom he particularly admired, had left that fund. Under these circumstances, we find that this was a reasonable ground for recommending this transaction. Respondent also had a plausible response to Enforcement's query as to why he did not follow Govett's former manager and place DM into the fund that this manager had begun to operate. Respondent stated that he did not know if Govett's former manager's newly started fund was operable at that time, and that even if it had been, he believed it was more reasonable to recommend that his customer place money into a fund with an operating history.

Respondent testified that his research in mutual funds had shown him that each fund family generally produces one "star" fund and that he would recommend this fund to his customers. There is no evidence in the record to show that other comparable funds within the

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[10] But see Krull, 248 F.3d at 913, (noting that "[t]he explanation for [Krull's] sell recommendations was hardly convincing, however, when he was simultaneously making a buy recommendation to another customer"). Unlike Krull, Respondent was making similar recommendations for similar customers, based upon his research that those recommendations were suitable for those customers at that time.

same family were available for his customers to purchase, which may have resulted in fewer sales load charges.

The record shows that Respondent discussed with his clients the effect that the sales charges would have, and his opinion that those charges would be more than offset by the gains that would occur in their accounts from the switches. The record shows that the switches recommended by Respondent were not unsuitable from the perspective of a cost/equity ratio, which is based upon a reasonably expected rate of return.

We note that although a customer's long-term investment objective may not change, a customer may achieve that objective through investing in any of an array of available mutual funds. For example, an investor who is looking for growth may seek it through funds that invest in large-capitalization equities, mid-caps, small-caps, or a variety of business sectors. While mutual fund investing, as noted, is generally suitable for long-term investing only, customers need not be restricted to an investment if the financial gain or the investment objective to be achieved by the switch is not undermined by the transaction fees associated with the switch. See Notice to Members 94-16, supra. See also Richard Hoffman and Kirk Montgomery, 2000 SEC LEXIS at *74 ("Indeed it is common knowledge that mutual fund investors are turning over their holdings more rapidly than in the past and changing funds according to past performance or future expectations.") (citations omitted). A review of the individual switches shows that Respondent recommended funds within a fairly broad array of the choices available to achieve growth. The funds were invested in companies of varying sizes and stages of development, and although their objectives were similar, their investment styles were not identical. As NASD's examiner testified, the earlier investments were made in funds that tended to be less aggressive than those that were selected in the later period in review.

We therefore conclude that Respondent demonstrated that his recommendations in the transactions at issue were suitable because he based those recommendations on reasonable grounds in light of each customer's situation at the time. We affirm the Hearing Panel's finding that Enforcement did not meet its burden to present persuasive evidence and analysis sufficient to overcome Respondent's explanation. Our evaluation of all the evidence shows that Respondent's recommendations were based on reasonable grounds. Accordingly, we dismiss the complaint against Respondent.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

EXHIBIT A

SWITCHED FROM	DATE ACQUIRED	SWITCHED TO	DATE OF SWITCH	SALES CHARGE	NET COMMISSION
CUSTOMER H.C.					
IDEX Fund	*N/A*	*Vista Capital Growth Fund (A)*	*March 1994*		
Vista Capital Group Fund (A)	March 1994	Putnam Capital Appreciation Fund (B)	February/March 1995	N/A	$6,182.73
Putnam Capital Appreciation Fund (B)	February/March 1995	Pioneer Small Company Fund (A)	January 1996	$ 9,442.21 +15,456.43 $24,898.64	$4,699.19
CUSTOMER K.C.					
IDEX Fund 3	*March 1988 and February 1991*	*Vista Capital Growth Fund (A)*	*October/November 1993*		
Vista Capital Group Fund (A)	October/November 1993	Putnam Capital Appreciation Fund (B)	February 1995		$1,795.34
Putnam Capital Appreciation Fund (B)	February 1995	Pioneer Small Company Fund (A)	January 1996	$4,487.96	$2,208.72
Pioneer Small Company Fund (A)	*January 1996*	*Pioneer Cash Reserves Fund*	*October 1996*		
Pioneer Cash Reserves Fund	October 1996	Fidelity Cash Reserves Fund	November 1996/ February 1997	$4,417.45	
Fidelity Cash Reserves Fund	November 1996	Pioneer Micro Cap Fund	March 1997		$2,574.00
CUSTOMER E.B.					
IDEX Fund	*1991/1993*	*Vista Capital Growth Fund (A)*	*December 1993*		
Vista Capital Growth Fund (A)	December 1993	Putnam Capital Appreciation Fund (B)	February 1995		$1,354.53
Putnam Capital Appreciation Fund (B)	February 1995	Pioneer Small Company Fund (A)	January/September 1996	$3,432.85	$1,666.13
Pioneer Small Company Fund (A)	*January/September 1996*	*Pioneer Cash Reserves Fund*	*October 1996*		
Pioneer Cash Reserves Fund	October 1996	Fidelity Cash Reserves Fund	November 1996/ February 1997	$3,369.76	
Fidelity Cash Reserves Fund	November 1996/ January 1997	John Hancock Special Equities Fund (B) MRS Emerging Growth Fund (B)	February 1997		$1,355.68 $1,936.68

CUSTOMER D.M.					
IDEX Fund	*1993/1994*	*Oppenheimer Main St. Income & Growth Fund (A)*	*March 1994*		
Oppenheimer Main St. Income & Growth Fund (A)	March 1994	Govett Smaller Companies Fund (A)	May 1995	$2,126.50	$ 912.89
Govett Smaller Companies Fund (A)	May 1995	Pioneer Small Company Fund (A)	November 1995	$2,514.63	$1,257.31
CUSTOMER S.B.					
IDEX Fund 3	*1987-1994*	*Oppenheimer Main St. Income & Growth Fund (A)*	*February/March 1994*		
Oppenheimer Main St. Income & Growth Fund (A)	February/March 1994	Putnam Capital Appreciation Fund (B)	February/March 1995		$ 580.07
Putnam Capital Appreciation Fund (B)	February/March 1995	Pioneer Small Company Fund (A)	March 1996	$1,159.82	$ 746.91

Note: The shaded trades in italics are not alleged to be unsuitable switches.