BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of	
Department of Enforcement, Complainant,	DECISION
	Complaint No. E9A2004048801
vs.	Dated: December 16, 2008
Brian J. Kelly Baltimore, MD, Respondent.	

Respondent churned a customer's account, made unsuitable recommendations to the customer, and exercised discretion in the customer's account without written authority. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Leo F. Orenstein, Esq., Department of Enforcement, Financial Industry Regulatory Authority

For the Respondent: Kevin F. Arthur, Esq.

Decision

Pursuant to NASD Rule 9311, Brian J. Kelly ("Kelly") appeals a July 12, 2007 Hearing Panel decision. In that decision, the Hearing Panel found that Kelly churned a customer's account, in violation of Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), Exchange Act Rule 10b-5 ("Rule 10b-5"), NASD Rule 2120 ("Rule 2120"), and NASD Rule 2110 ("Rule 2110").[1] The Hearing Panel also found that Kelly made unsuitable recommendations to a customer in violation of NASD Rule 2310 ("Rule 2310"), Rule 2110, and NASD IM-2310-2 ("IM-2310-2").

[1] Rule 2110 requires the observance of high standards of commercial honor and just and equitable principles of trade. A violation of an SEC or FINRA rule also constitutes a violation of Rule 2110. *See Steven J. Gluckman,* 54 S.E.C. 175, 185 (1999).

The Hearing Panel imposed a separate bar on Kelly for each of these violations. In addition, the Hearing Panel found that Kelly exercised discretion in a customer's account without written authority, in violation of NASD Rule 2510 ("Rule 2510") and Rule 2110. In light of the bars for the churning and suitability violations, the Hearing Panel did not impose an additional sanction for Kelly's violation of Rules 2510 and 2110. After thoroughly reviewing the record and considering the parties' oral arguments, we affirm the findings made and modify the sanctions imposed by the Hearing Panel.

I. Background

Kelly first became registered with a FINRA member firm as a general securities representative in April 1992. During the time relevant to our decision, Kelly was associated with First Union Securities, Inc ("First Union"). Kelly is not currently associated with a FINRA member.

II. Procedural History

On June 2, 2006, FINRA's Department of Enforcement ("Enforcement") filed a three-cause complaint against Kelly for misconduct associated with trading in a single customer's account. Cause one alleged that Kelly churned the customer's account. Cause two alleged that Kelly made unsuitable recommendations and engaged in the excessive use of margin in the customer's account. Cause three alleged that Kelly exercised discretion in the customer's account without written authority. On June 28, 2006, Kelly filed an answer denying that he was liable and seeking dismissal of the complaint.

The Hearing Panel conducted a hearing on April 11 and 12, 2006. In a decision issued on July 17, 2007, the Hearing Panel found Kelly liable for all three causes alleged in the complaint. The Hearing Panel imposed separate bars for causes one and two. In light of these bars, the Hearing Panel did not impose an additional sanction for Kelly's violation under cause three. Kelly appealed the Hearing Panel's decision.

III. Facts

Around 1998, Kelly started appearing on a call-in radio show about stocks and investment ideas. In 2000, the show focused on "hot" stocks in the "dot com" or technology sector. At that time, customer GM was 56 years old and had retired from Bethlehem Steel after a 27-year career as a mill mechanic.[2] After listening to Kelly's show for several weeks, GM contacted Kelly in early 2001 to arrange a meeting.

[2] In addition, GM owned a pretzel business and also helped oversee construction projects in residences that his son purchased to rehabilitate and resell. GM testified that he did not receive income from these construction projects.

Kelly testified that GM "wanted to get involved in" day trading. Kelly asserted that he explained his active day trading strategy to GM at the meeting. Kelly conceded, however, that GM may not have been aware that day trading involved buying and selling stocks on the same day. Kelly also conceded that he does not believe that he discussed with GM "the costs" associated with day trading, such as the commissions that a day trading strategy generates. Moreover, Kelly did not have any discussions with GM regarding GM's prior investment experience. GM testified that he personally did not know "too much" about stocks and "always relied on whoever was taking care of my account to give me advice and tell me what needed to be done and when."

Prior to opening an account with First Union, GM had a brokerage account at Alex Brown & Sons, Inc. ("Alex Brown") worth approximately $250,000. The account was invested mostly in a money market account and mutual funds. GM opened an account with First Union in February 2001.[3] In opening this account, GM told Kelly that he had a "medium" or "moderate" risk tolerance. GM's February 2001 account application reflected his moderate risk tolerance, as well as an investment objective of "growth." The application form also showed that GM had an annual income between $100,000 and $199,000, and a net worth between $500,000 and $999,999 (excluding his residence). The form also indicated that GM had an "average" knowledge of stocks and mutual funds.[4]

Initially, Kelly discussed potential trades with GM before making them. Thereafter, events in GM's personal life made it difficult for Kelly to reach him by phone.[5] Consequently, Kelly asked GM for authority to effect trades on his behalf, and GM signed a discretionary trading authorization form on April 11, 2001.[6]

In order to obtain discretionary trading authority in GM's account, First Union required Kelly to obtain approval from: (1) his branch manager, Matt Glenn ("Glenn"), (2) his regional director, and (3) the compliance department. These requirements were stated explicitly in First Union's written procedures. These procedures contained bolded text stating that "Compliance

[3] The total portfolio value in the First Union account on February 28, 2001, was $282,097.82, and it was opened as a margin account.

[4] The form allowed GM to check off a box to indicate his knowledge. The choices were: (1) "None," (2) "Limited," (3) "Average," or (4) "Extensive."

[5] GM testified that during this time, his parents were "in and out of the hospital" and his daughter was "ill with cancer."

[6] GM testified that after signing the trading authorization form in April, he immediately saw a substantial increase in trade confirmations. This prompted GM to ask Kelly why he was "trading so much" and "buying and selling so quickly." According to GM, Kelly explained to him that this level of trading activity was required to "make money." GM also testified that once he authorized Kelly to exercise discretion in the account, months passed without any contact between them.

must accept the account before discretion is authorized." Glenn signed the discretionary trading form for GM's account on April 12, 2001. The regional director, however, did not sign the form until June 15, 2001.[7]

Before the compliance department could approve Kelly's discretionary authority, he began pursuing a high-risk day trading strategy in GM's account that included the use of margin. On May 14, 2001, a margin activity report was generated showing a $396,288 margin balance in GM's account.

On July 10, 2001, the compliance department denied Kelly discretionary authority for GM's account, citing the level of trading activity and losses in the account. The compliance department also placed a 90-day freeze on day trading in GM's account and directed Glenn to "thoroughly discuss" with Kelly the account's trading activity, as well as GM's goals and objectives. Kelly testified that he and Glenn met with GM in August 2001 to discuss GM's investment philosophy and strategy. At this meeting, Kelly did not tell GM that First Union's compliance department had not approved the account for discretionary trading and had instituted a 90-day freeze on day trading in GM's account. Instead, Kelly's notes from the meeting state that he and GM discussed "staying put for the next three months."

Shortly after the 90-day freeze on GM's account ended in October 2001, Kelly began day trading the account again. During November and December 2001, Kelly made a total of 87 trades in GM's account.[8] By the end of 2001, the value in GM's account had dropped approximately $57,000 or 20 percent since it opened in February 2001.

In January 2002, Glenn sent GM a request to update his account objective from "moderate" growth to "aggressive" growth. GM did not respond to this letter. Glenn sent a follow-up letter asking GM to sign and return an acknowledgment form stating that it was GM's "trading objective (notwithstanding previously stated or recorded account objectives) to effect short-term transactions in securities . . . recognizing that such trading involves risk of financial loss and may generate substantial commission charges." GM testified that he "wasn't really positive that [he] wanted to sign" the acknowledgment form and that he did not fully understand Glenn's letter. GM, however, signed the acknowledgment form on March 4, 2002. Despite the fact that GM signed the acknowledgment form, the investment objective on GM's account form remained unchanged.

[7] The assistant to the regional director signed the form on the regional director's behalf.

[8] Kelly claimed that GM asked to be more involved with the account at the August 2001 meeting, and that Kelly subsequently called GM before every trade. Glenn testified that he briefly attended the August 2001 meeting and concluded that it was GM's decision to day trade a portion of his account.

At some point prior to July 2002, GM discussed investment in mutual funds with Kelly because GM's daughter told him that mutual funds were a more sensible investment.[9] In July 2002, Kelly purchased two mutual funds for GM, but otherwise ceased trading his account.

Almost two years later, GM wrote to Glenn on March 23, 2004, complaining that the level of trading in his First Union account in 2001 was unsuitable. In August 2004, GM's attorney filed a written complaint with FINRA regarding Kelly's handling of GM's account. GM subsequently filed an arbitration claim against First Union and Kelly.[10]

The parties stipulated that from May 1, 2001, through July 31, 2002 ("the relevant period"): (1) purchases totaling $7.79 million were made in GM's account, (2) Kelly received $33,291.41 in net commissions for these trades, (3) the account value declined by approximately $90,000, (4) the total margin interest charged was $3,348.58, (5) the annualized turnover rate in GM's account was 30.18, (6) the commission-to-equity ratio was 33.14 percent, and (7) the cost-to-equity ratio was 34.45 percent.

Kelly conceded that the trading in GM's account during the relevant period was unsuitable and expressed "deep regret for . . . any actions that [he] took that led to losses for" GM. Kelly also stated that he has not engaged in this type of trading in many years and that the "situation that occurred with [GM] . . . will not happen again."

IV. Discussion

After reviewing the record, we affirm the Hearing Panel's findings that Kelly churned GM's account, made unsuitable recommendations, and exercised discretion in GM's account without written authority. We discuss each of these violations in detail below.

A. Kelly Churned GM's Account

Churning violates Section 10(b) of the Exchange Act, Rule 10b-5, and Rules 2120 and 2110.[11] The Commission has explained that "'[c]hurning occurs when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interests, for the purpose of generating commissions.'" *Sandra K. Simpson*, 55 S.E.C. 766, 796

[9] The record does not reveal the exact timing of this discussion, but Kelly testified that it was around the time that the Enron, WorldCom, and Tyco scandals hit the market.

[10] GM's arbitration claim was ultimately settled. Kelly contributed to the settlement, but the record does not clearly reflect the amount of the settlement or the amount of Kelly's contribution.

[11] Rule 2120 states that "[n]o member shall effect any transaction in, or induce the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." Pursuant to NASD Rule 0115(a), rules such as Rule 2120 that are applicable to "members" are also applicable to persons associated with a member.

(2002) (*quoting Olson v. E.F. Hutton & Co.*, 957 F.2d 622, 628 (8th Cir. 1992) (citation omitted)).

Churning has been found where: (1) the broker exercised control over the account; (2) trading in an account was excessive in light of the investment objectives; and (3) the broker acted with the intent to defraud or with reckless disregard for the interests of the client. *See Donald A. Roche*, 53 S.E.C. 16, 22 (1997). The Hearing Panel found that Kelly controlled GM's account when he effected trades in the account during the relevant period. In addition, the Hearing Panel found that the level of trading activity during this period was excessive and that Kelly demonstrated a reckless disregard for GM's interests by pursuing such trading. We agree with the Hearing Panel and therefore affirm its finding that Kelly churned GM's account.

1. Kelly Controlled GM's Account

Control is established if a broker has formal discretionary authority over an account. *See Follansbee v. Davis, Skaggs & Co., Inc.*, 681 F.2d 673, 676 (9th Cir. 1982) (stating that "[i]f a broker is formally given discretionary authority to buy and sell for the account of his customer, he clearly controls it"). A broker who does not have formal discretionary authority may still exercise *de facto* control of the account if the customer "so relies upon the broker that the [broker] is in a position to control the volume and frequency of transactions in the account." *John M. Reynolds*, 50 S.E.C. 805, 807-08 (1991). Here, the evidence shows that: (1) Kelly had actual control of GM's account from May 1 to July 10, 2001, (2) from July 10, 2001 to July 2002, Kelly had *de facto* control over the volume and frequency of transactions in GM's account that allowed Kelly to execute an aggressive day trading strategy, and (3) GM relied on Kelly to trade the account.

Although First Union never approved Kelly's use of discretionary authority for GM's account, GM authorized discretionary trading in his account beginning in April 2001. Kelly concedes that he exercised discretion in GM's account from around this time until July 10, 2001, when First Union notified Kelly that his request for discretionary authority was rejected and that the Firm was imposing a 90-day freeze on day trading in the account. After the 90-day freeze, Kelly resumed aggressive day trading in GM's account. In the two months after the freeze was lifted, Kelly made a total of 87 trades in the account. Kelly continued to actively trade the account until July 2002, when GM's daughter advised GM that mutual funds would be a more stable investment.

The volume of transactions effected by Kelly in GM's account, considered in light of the overall record, suggests that Kelly exercised discretionary authority over the account.[12]

[12] Due to the high volume of trading, the Hearing Panel did not find credible Kelly's contention that after July 2001, he ceased exercising discretion and spoke with GM by telephone before every trade. On appeal, Kelly argues that the Hearing Panel's finding that he continued to exercise discretion in GM's account is "discredited" by Kelly's own testimony. The Commission has held, "credibility determinations of an initial fact finder are entitled to considerable weight." *Laurie Jones Canady*, 54 S.E.C. 65, 78 n.23 (1999) (*citing Anthony*

[Footnote continued on next page]

Moreover, the Hearing Panel credited GM's testimony that once he authorized discretionary trading in his account, GM had little contact with Kelly despite the high volume of transactions in the account.[13] GM also testified that he had "faith" in Kelly, did not know much about stocks, and "always relied" on his brokers to direct the trading in his account. Accordingly, we find that GM relied on Kelly's investment advice and that Kelly had *de facto* control of GM's account from roughly July 2001 to July 2002. *See Roche*, 53 S.E.C. at 23 n.14 (stating that "[d]e facto control of an account may be established where the client habitually follows the advice of the broker.").

2. Excessive Trading

Where a broker has actual or *de facto* control of investment decisions in an account, excessive trading may be found based solely on the annual turnover rate in the account. *Rafael Pinchas*, 54 S.E.C. 331, 340 n.17 (1999) (*citing David A. Gingras*, 50 S.E.C. 1286, 1289 (1992)). The annual turnover rate measures the number of times during a given year that the securities in an account are replaced by new securities. *Id.* at 339. Generally, an annual turnover rate of six or higher reflects excessive trading. *Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 490 (6th Cir. 1990); *David Wong*, 55 S.E.C. 602, 611 n.18 (2002); *Peter C. Bucchieri*, 52 S.E.C. 800, 805 (1996). Here, the annual turnover rate in GM's account was 30.18. This is well beyond the level that would normally constitute excessive trading.[14]

In addition, the account's commission-to-equity and cost-to-equity ratios were 33.14 percent and 34.45 percent respectively.[15] These ratios indicate that GM's account would have had to make gains of more than 33 percent just to break even. Under these circumstances, we

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Tricarico, 51 S.E.C. 457, 460 (1993)). Here, the Hearing Panel evaluated Kelly's testimony and found that Kelly lacked credibility. We find nothing in the record that would lead us to overturn the Hearing Panel's finding. *Dane S. Faber*, Exchange Act Rel. No. 49216, 2004 SEC LEXIS 277, at *17-18 (Feb. 10, 2004).

[13] GM's testimony is buttressed by Kelly's admission that he never even told GM of First Union's failure to approve discretionary trading in GM's account.

[14] The Commission has found trading to be excessive where the turnover ratios were much lower than the ratio for GM's account. *See Gerald E. Donnelly*, 52 S.E.C. 600, 602-603 & 603 n.11 (finding annualized turnover ratios between 3.1 and 3.8 to be excessive); *Samuel B. Franklin & Co.*, 42 S.E.C. 325, 330 (1964) (finding turnover ratios of 3.5 and 4.4 to be excessive).

[15] *See Daniel Richard Howard*, 55 S.E.C. 1096, 1100 (2002) (finding that a cost-to-equity ratio of 20 percent generally indicates excessive trading); *see also Harry Gliksman*, 54 S.E.C. 471, 477 (1999), *aff'd*, 24 F. App'x 702 (9th Cir. 2001) (finding that a commission-to-equity ratio of 21 percent was excessive).

easily find that this level of trading was excessive for GM, whose investment objective was "growth" and who had a "moderate" risk tolerance. *See Roche*, 53 S.E.C. at 22 (finding that respondent churned customer accounts where the frequent turnover in the accounts conflicted with the customers' expressed investment objectives).

3. Scienter

In a churning case, scienter may be established by showing a broker's "reckless disregard for the customer's interests." *Michael T. Studer*, Exchange Act Rel. No. 50543, 2004 SEC LEXIS 2347, at *16 (Oct. 14, 2004). Such disregard may be inferred from the amount of commissions charged by the broker. *Id.* at *17-18 (stating that "[t]he generation of commissions as a goal overriding the client's interests evidences scienter in churning.").

Here, Kelly generated more than $33,000 in net commissions from GM's account over a period where the account with an initial value of $282,097.82 saw a decline in value of approximately $90,000. This occurred despite the fact that GM opened the account indicating that he only had a moderate risk tolerance. Moreover, Kelly began day trading GM's account immediately after the expiration of a 90-day freeze on day trading imposed by the Firm. Kelly resumed his day trading strategy in GM's account despite the fact that the Firm implemented the freeze because of the significant margin balance created by Kelly's strategy. Thus, Kelly ignored the Firm's warning and exposed GM's account to the same risky strategy without consideration of whether the strategy was consistent with GM's financial situation and without any change in the customer's investment objectives. Under these circumstances, we find that Kelly had a reckless disregard for GM's interests and the requisite scienter to establish a churning violation. *See Studer*, 2004 SEC LEXIS 2347, at *18 (citing the respondent's decision to continue the same active trading strategy that had earlier prompted the firm to halt trading in a customer's account as evidence of scienter needed to establish churning); *see also Roche*, 53 S.E.C. at 23 (citing the fact that a broker's customers sustained large losses while he was generating substantial commission income for himself to demonstrate that the broker acted in reckless disregard of his customers' interests). We therefore affirm the Hearing Panel's finding that Kelly churned GM's account in violation of Exchange Act Section 10(b), Rule 10b-5, and Rules 2120 and 2110.

B. Kelly Recommended Unsuitable Transactions

Under FINRA's suitability rule, a registered representative must have a reasonable basis for believing that a recommended transaction is suitable based on the customer's investment objectives and financial situation.[16] It is well settled that the quantity of trading in an account may render the trading unsuitable. "[E]xcessive trading represents an unsuitable frequency of

[16] Rule 2310(a) provides that, when recommending the purchase, sale or exchange of any security to a customer, a registered representative "shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

trading and violates NASD's suitability standards." *Paul C. Kettler*, 51 S.E.C. 30, 32 (1992); *see also* IM-2310-2 (prohibiting a broker from trading excessively in a customer's account). The high turnover rate, commission-to-equity ratio and cost-to-equity ratio for GM's account establish that Kelly excessively traded the account in violation of the suitability rule. Indeed, Kelly does not dispute that the trading in GM's account was unsuitable for GM.[17]

Kelly, however, claims that GM ratified the excessive trading in the account after the fact by signing the acknowledgment form in March of 2002.[18] Specifically, Kelly argues that he had the right to rely on GM's representations in the acknowledgment form that Kelly's trading of the account was consistent with GM's investment objectives. The test for whether a broker's recommendations are suitable, however, is not whether the customer acquiesced in them, but whether the recommendations were consistent with the customer's financial situation and needs. *See James B. Chase*, Exchange Act Rel. No. 47476, 2003 SEC LEXIS 566, at *18 (Mar. 10, 2003); *see also Faber*, 2004 SEC LEXIS 277, at *24 (stating that "[a] recommendation is not suitable merely because the customer acquiesces in the recommendation.").

GM's financial situation was not compatible with the aggressive day trading of technology stocks that occurred in his account. GM had limited investment experience, his previous investments consisted only of a money market account and mutual funds, and his risk tolerance was moderate. *Cf. id.* at *24-27 (finding respondent's recommendations of speculative technology stock were unsuitable when customer was an inexperienced investor, had previously invested only in certificates of deposit and savings accounts, and could not afford to lose substantially all of her account's assets).

Kelly was obligated to determine whether his high-risk day trading strategy was suitable for GM based on an assessment of GM's overall financial situation—even if GM expressed a desire to pursue this strategy in the acknowledgment form. *See Jack H. Stein,* Exchange Act Rel. No. 47335, 2003 SEC LEXIS 338, at *8 (Feb. 10, 2003) (stating that "[e]ven in cases in which a customer affirmatively seeks to engage in highly speculative or otherwise aggressive trading, a representative is under a duty to refrain from making recommendations that are incompatible with the customer's financial profile."). The March 4, 2002 letter therefore did not justify Kelly's pursuit of a high-risk strategy in a volatile market for a customer who did not have the financial means to withstand significant losses.

Moreover, GM signed the acknowledgment form more than nine months *after* Kelly adopted his high-risk strategy for GM's account. At the time that GM opened his First Union account, Kelly should have recognized that a high-risk day trading strategy was not suitable for

[17] Kelly admits that the trading in GM's account was not suitable for a person of GM's means and income and may not have been suitable for any of Kelly's customers.

[18] The acknowledgment form indicated that: (1) GM was aware of the level of activity in his account, (2) his trading objective was to effect short-term transactions in securities and/or listed options, and (3) all prior transactions had been made with his prior approval and in accordance with his overall investment/trading objectives.

GM based on the information in GM's account application. Instead, Kelly primarily relied on GM's purported unhappiness with the conservative nature of his Alex Brown account and GM's prior experience as an entrepreneur to determine that the high-risk day trading strategy would be suitable for GM. Rather than seeking GM's ratification of Kelly's unsuitable trading after the fact, Kelly had an obligation to make sure that the high-risk day trading was suitable for GM at the time that Kelly made the recommendations. *See Chase*, 2003 SEC LEXIS 566, at *16 (stating that under the suitability rule, the respondent "was obligated to consider [his customer's] financial profile and needs when he made the recommendations.").

Under these circumstances, we find that Kelly violated Rules 2310(a) and 2110, and IM 2310-2 by recommending a trading strategy that offered risks incompatible with GM's investment objectives and financial needs.

C. Kelly Exercised Discretion Without Written Authority

Rule 2510 prohibits a registered representative from exercising discretion in a customer's account without prior written authorization from both the customer and the firm.[19] It is undisputed that First Union's compliance department never authorized Kelly to exercise discretion in Kelly's account. In fact, First Union's compliance department rejected Kelly's request for discretionary trading authority in GM's account in July 2001. Kelly admits that for roughly two months, he violated Rule 2510 by exercising discretion in GM's account without the compliance department's approval. Kelly testified, however, that he mistakenly believed Glenn's approval alone was sufficient to authorize discretionary trading in GM's account.

As an initial matter, Kelly's mistake does not excuse his Rule 2510 violation because a registered representative is presumed to know and abide by FINRA rules and his or her member firm's compliance guidelines. *See, e.g., Carter v. SEC*, 726 F.2d 472, 474 (9th Cir. 1983); *Sirianni v. SEC*, 677 F.2d 1284, 1288 (9th Cir. 1982); *Gershon Tannenbaum*, 50 S.E.C. 1138, 1141 (1992). In addition, the record demonstrates that Kelly had little basis for his belief that Glenn's approval alone was sufficient to authorize Kelly's discretionary trading. First Union's written procedures expressly provided that discretionary trading authority required three levels of approval. This requirement was reinforced by the three signature blocks appearing on the Firm's discretionary trading authorization forms. Moreover, First Union's procedures highlighted in bold text the fact that no discretionary authority could be exercised by a broker until the Firm's compliance department approved such authority. The Hearing Panel considered these facts and did not credit Kelly's testimony that he mistakenly believed he had authority to exercise discretion in GM's account prior to July 2001. We see no reason to overturn the Hearing Panel's credibility determination. *See Faber*, 2004 SEC LEXIS 277, at *17-18.

[19] Rule 2510(b) provides, in pertinent part, 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."

Similarly, Kelly's testimony that he ceased exercising discretion in GM's account after the Firm imposed a 90-day freeze in July 2001 is undermined by several facts in the record. First, after the freeze was lifted in October 2001, Kelly traded the account with an aggressive day trading strategy—one that mirrored the strategy Kelly used when he initially exercised discretion in the account without the Firm's authorization. Second, Kelly admitted that he never told GM that the Firm did not approve discretionary trading authority in the account. Third, GM credibly testified that he did not have much contact with Kelly after GM agreed to give Kelly discretionary trading authority in April 2001.[20] Finally, as the Hearing Panel noted, Kelly's credibility on the issue of whether he exercised discretion in GM's account after July 2001 is questionable because, although Kelly testified that he exercised discretion in the account for at least two months, he also represented on two different First Union questionnaires, one dated August 29, 2001, and another dated June 21, 2002, that he *never* exercised discretion in GM's account.[21]

As noted previously, the Hearing Panel did not credit Kelly's testimony that he ceased his unauthorized use of discretion in July 2001. Consequently, we find that Kelly violated Rules 2510 and 2110 by exercising discretion in GM's account without written authority.

V. Sanctions

The Hearing Panel barred Kelly from associating with any FINRA member in any capacity for his churning violation and imposed a separate bar on Kelly for his suitability violation. In light of these bars, the Hearing Panel did not impose an additional sanction for Kelly's exercise of discretion without written authority. We have considered the FINRA Sanction Guidelines ("Guidelines") in determining the appropriate sanction for Kelly's violations, as well as the potentially mitigating factors raised by Kelly on appeal. We find that the bars imposed by the Hearing Panel for Kelly's violations were not appropriately remedial, and we modify these sanctions as discussed below. We further find it appropriate to impose a sanction for Kelly's exercise of discretion without written authority.

[20] The Hearing Panel found that GM was more credible than Kelly on this issue. We do not disturb the Hearing Panel's credibility determination. *See Faber*, 2004 SEC LEXIS 277, at *17-18.

[21] Kelly claims that he mistakenly made these statements because he was not exercising discretion at the time he completed the form. Even if it was a mistake, we do not find that the evidence in the record supports a reversal of the Hearing Panel's credibility determination. *Cf. Keith Springer*, 55 S.E.C. 632, 644 (2002) (citing evidence that respondent's testimony was inconsistent with documentary and testimonial evidence in deciding not to overturn NYSE hearing panel's credibility determination).

A. Churning and Suitability

The Guidelines for churning provide for a fine ranging from $5,000 to $75,000 plus the amount of the respondent's financial benefit.[22] The Guidelines also recommend a suspension in any or all capacities for 10 business days to one year.[23] In egregious cases, the Guidelines recommend consideration of a longer suspension (of up to two years) or a bar.[24] The Guidelines for a suitability violation are identical except that the recommended fine for a suitability violation ranges from $2,500 to $75,000.[25] In imposing sanctions for each of these violations, we also consider the "Principal Considerations in Determining Sanctions" set forth in the Guidelines.[26]

The Hearing Panel found that Kelly's churning and suitability violations were egregious. We agree. In addition, we find it aggravating that Kelly intentionally churned GM's account for an extended period lasting approximately one year.[27] During this period, Kelly ceased churning GM's account only when First Union imposed a mandatory 90-day freeze on the account, but he immediately resumed churning the account when the freeze was lifted. Also during this period, Kelly benefited from his misconduct, generating more than $33,000 in net commissions.[28] Kelly's misconduct also caused injury to GM in the amount of roughly $90,000 in losses.[29] In addition, GM was not a sophisticated investor, and because of his limited investment experience, he relied heavily on Kelly.[30]

The Hearing Panel found that there were no mitigating factors in this case and imposed separate bars for Kelly's churning and suitability violations. In our review of the record,

[22] *FINRA Sanction Guidelines* 82 (2007), http://www.finra.org/web/groups/enforcement/documents/enforcement/p011038.pdf [hereinafter *Guidelines*].

[23] *Id*.

[24] *Id*.

[25] *Id.* at 99.

[26] *Id.* at 6-7 (Principal Considerations in Determining Sanctions). The Guidelines list no specific factors to consider when determining sanctions for either of these violations.

[27] *Id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 9 and 13).

[28] *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 17).

[29] *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 11).

[30] *Id*. at 7 (Principal Considerations in Determining Sanctions, No. 19).

however, we find factors that when considered in their entirety, mitigate Kelly's misconduct.[31] First, Kelly's misconduct involved a single customer account.[32] Second, the transactions at issue occurred during a unique period of market decline. Third, Kelly has accepted responsibility for his misconduct and consistently expressed remorse.[33] In addition, Kelly conceded that the trading in GM's account was unsuitable and expressed "deep regret" for his actions.[34] Finally, since the violation occurred, Kelly indicated that he changed his practice model and for years has not engaged in the type of short-term day trading strategy that led to this disciplinary action.[35]

Even after considering each of these mitigating factors, we find that sanctions at the highest end of the recommended ranges for churning and suitability violations are both necessary

[31] The same factors that aggravate and mitigate Kelly's churning violation also apply to his suitability violation.

[32] *Id.* at 7 (Principal Considerations in Determining Sanctions, No. 18).

[33] Kelly contends that his contribution to the settlement arising from GM's arbitration claim should be considered a mitigating factor. Kelly's contention is without merit. Under the Guidelines, such contributions are only considered mitigating when they are voluntary. *See Guidelines*, at 6 (Principal Considerations in Determining Sanctions, No. 4). Here, Kelly has offered little information about the settlement, including whether or not his contribution to the settlement was voluntary.

[34] The Hearing Panel acknowledged Kelly's expression of remorse, but concluded that he did not take responsibility for his actions until long after disciplinary charges were filed. While we agree that accepting responsibility has the greatest mitigative weight when it occurs prior to regulatory intervention, we find some mitigative value in Kelly's frank admission to the Hearing Panel that the trading in GM's account was not suitable for GM and probably not suitable for any of his customers. *Cf. Dep't of Enforcement v. Dunbar*, Complaint No. C07050050, 2008 FINRA Discip. LEXIS 18, at *40 (FINRA NAC May 20, 2008) (rejecting respondent's expression of remorse as a mitigating factor where respondent continued to dispute that his conduct violated the suitability rule); *Dep't of Enforcement v. Asensio Brokerage Servs., Inc.*, Complaint No. CAF030067, 2006 NASD Discip. LEXIS 20, at *52 (NASD NAC July 28, 2006) (finding no mitigation where respondent did not accept responsibility for his misconduct until after he appealed the Hearing Panel's decision). *See also Kevin Eric Shaughnessy*, 53 S.E.C. 692, 699 (1998) (concluding that respondent did not accept responsibility where he attributed his misconduct to inadequate training).

[35] We do not consider it mitigating that GM signed the acknowledgement form stating that it was GM's objective to pursue "short term transactions" as part of Kelly's day trading strategy. Although the acknowledgment form indicated that GM was willing to engage in some amount of short term transactions, the extreme quantity of transactions effected by Kelly under this strategy—as well as the losses and commissions generated—showed a reckless disregard for GM's overall interests.

and proportional to the seriousness of Kelly's violations. Accordingly, we find that a two-year suspension and $108,291.41 fine[36] for Kelly's churning violation and a separate two-year suspension and $108,291.41 fine for Kelly's suitability violation would be an appropriately remedial sanction for each of these violations.

The Guidelines, however, authorize the aggregation of individual violations for purposes of determining sanctions if, among other things, the violations were the result of a single, underlying problem. *See Guideline*s at 4 (General Principles Applicable To All Sanction Determinations, No. 4). Here, both the churning and suitability violations arose from Kelly's excessive trading of GM's account. We therefore impose a single sanction for these violations consisting of a two-year suspension and $108,291.41 fine.

B. Exercising Discretion Without Written Authority

The Guidelines do not address the specific facts of this case, namely, where a respondent had the customer's written authority, but failed to obtain the firm's written authority to exercise discretion. The most analogous Guidelines are those covering the exercise of discretion without a customer's written authority. These Guidelines recommend a fine between $ 2,500 and $10,000.[37] The Guidelines further recommend that, in egregious cases, we consider suspending the respondent in any or all capacities for 10 to 30 business days. The Guidelines list as principal considerations in determining sanctions: (1) whether the customer's grant of discretion was express or implied, and (2) whether the firm's policies and/or procedures prohibited discretionary trading and/or whether the firm prohibited respondent from exercising discretion in customer accounts.[38] For Kelly's exercise of discretion in GM's account without First Union's written authority, the Hearing Panel indicated that Kelly's misconduct was serious and that a fine and suspension in the upper range of the Guidelines' recommendation would be appropriate. The Hearing Panel did not, however, impose any sanction in light of the bars it imposed for the churning and suitability violations.

We find that Kelly's misconduct was egregious. Moreover, there are significant aggravating factors associated with his misconduct. For example, we find it aggravating that although GM expressly approved Kelly's discretionary authority, Kelly did not properly seek approval from First Union's compliance department even though: (1) First Union's written procedures expressly required such approval; and (2) the Firm's discretionary trading authorization form also indicated that such approval was necessary. We also find it aggravating

[36] This sanction represents a $75,000 fine plus a $33,291.41 disgorgement of Kelly's ill-gotten gains from the net commissions charged to GM during the relevant period. *See Guidelines* at 10 (Technical Matters, Monetary Sanctions – Imposition and Collection of Monetary Sanctions).

[37] *Guidelines*, at 90.

[38] *Id*.

that Kelly continued to exercise discretion in the account for more than seven months after he learned that First Union's compliance department had not approved discretion for the account.

After considering each of these factors, we find that a sanction at the highest end of the Guidelines' recommended range for this violation is appropriate. We therefore fine Kelly $10,000 and suspend him in all capacities for 30 business days for exercising discretion in GM's account without written authority.

VI. Conclusion

We find that Kelly churned GM's account in violation of Exchange Act Section 10(b), Rule 10b-5, Rules 2120 and 2110. In addition, we find that Kelly made unsuitable recommendations to GM in violation Rules 2310 and 2110 and IM-2310-2. We further find that Kelly exercised discretion without written authority in violation of Rules 2510 and 2110.[39] For Kelly's churning and suitability violations, we impose a single sanction consisting of a two-year suspension and a $108,291.41 fine. We also impose a 30-business-day suspension (to be served concurrently) and a $10,000 fine for Kelly's violation of Rules 2510 and 2110.[40] Accordingly, we suspend Kelly for a total of two years and order him to pay a fine amounting to $118,291.41. We also order Kelly to pay hearing costs in the amount of $4,094.46.[41]

On Behalf of the National Adjudicatory Council,

____
Marcia E. Asquith, Senior Vice President and
Corporate Secretary

[39] We have also considered and reject without discussion all other arguments advanced by the parties.

[40] The Guidelines recommend that suspensions not exceed two years because misconduct that merits a suspension of more than two years should probably warrant a bar. *See Guidelines* at 11 (Technical Matters: Suspensions, bars and expulsions). Because we do not conclude that Kelly's misconduct merits a bar, we order that the suspensions imposed be served concurrently.

[41] Pursuant to NASD Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.

Leavy Mathews III Direct: (202) 728-8497
Assistant General Counsel Fax: (202) 728-8264

December 16, 2008

VIA MESSENGER

Florence E. Harmon
Acting Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

A. RE: Complaint No. E9A2004048801: Brian J. Kelly

Dear Ms. Harmon:

Enclosed please find the decision of the National Adjudicatory Council ("NAC") in the above-referenced matter. The FINRA Board did not call this matter for review, and the attached NAC decision is the final decision of FINRA.

Very truly yours,

Leavy Mathews III

Enclosure

Marcia E. Asquith
Senior Vice President and
Corporate Secretary

Direct: (202) 728-8831
Fax: (202) 728-8300

December 16, 2008

VIA CERTIFIED MAIL:
RETURN RECEIPT REQUESTED/FIRST-CLASS MAIL

Brian J. Kelly
609 Lakeland Road
Severna Park, MD 21146

Re: Complaint No. E9A2004048801: Brian J. Kelly

Dear Mr. Kelly:

Enclosed is the decision of the National Adjudicatory Council ("NAC") in the above-referenced matter. The Board of Governors of the Financial Industry Regulatory Authority ("FINRA") did not call this matter for review, and the attached NAC decision is the final decision of FINRA.

B. In the enclosed decision, the NAC imposes a single sanction of a $108,291.41 fine and a two-year suspension for (1) churning a customer account in violation Exchange Act Section 10(b), SEC Rule 10b-5, and NASD Rules 2120 and 2110; and (2) making unsuitable recommendations in violation of NASD Rules 2310 and 2110 and NASD IM-2310-2. In addition, the NAC imposes a $10,000 fine and 30 business-day suspension (to be served concurrently) for exercising discretion in a customer account without written authority in violation of Rules 2510 and 2110. The NAC also orders you to pay hearing costs in the amount of $4,094.66.

Pursuant to Article V, Section 2 of the FINRA By-Laws, if you are currently employed with a member of FINRA, you are required immediately to update your Form U4 to reflect this action.

You are also reminded that a failure to keep FINRA apprised of your most recent address may result in the entry of a default decision against you. Article V, Section 2 of the FINRA By-Laws requires all persons who apply for registration with FINRA to submit a Form U4 and to keep all information on the Form U4 current and accurate. Accordingly, you must keep your member firm informed of your current address.

In addition, FINRA may request information from, or file a formal disciplinary action against, persons who are no longer registered with a FINRA member for at least two years after their termination from association with a member. *See* Article V, Sections 3 and 4 of FINRA's By-Laws. Requests for information and disciplinary complaints issued by FINRA during this two-year period will be mailed to such persons at their last known address as reflected in FINRA's records. Such individuals are deemed to have received correspondence sent to the last known address, whether or not the individuals have actually received them. Thus, individuals who are no longer associated with a FINRA member firm and who have failed to update their addresses during the two years after they end their association are subject to the entry of default decisions against them. *See* Notice to Members 97-31. Letters notifying FINRA of such address changes should be sent to:

CRD
P.O. Box 9495
Gaithersburg, MD 20898-9401

You may appeal this decision to the U.S. Securities and Exchange Commission ("SEC"). To do so, you or your counsel must file an application with the SEC within 30 days of your receipt of this decision. A copy of this application must be sent to the FINRA Office of General Counsel, as must copies of all documents filed with the SEC. Any documents provided to the SEC via facsimile or overnight mail should also be provided to FINRA by similar means.

The address of the SEC is:

The Office of the Secretary
Securities and Exchange
Commission
100 F Street, N.E.
Mail Stop 1090 – Room 10915
Washington, D.C. 20549

The address of FINRA is:

Attn: Leavy Mathews III, Esq.
Office of General Counsel

FINRA
1735 K Street, N.W.
Washington, D.C. 20006

If an application for review is filed with the SEC, the application must identify the FINRA case number and state the basis for appeal, include an address where service may be effected, and include a phone number where you or your counsel may be reached during business hours. Attorneys must file a notice of appearance. The filing with the SEC of an application for review shall stay the effectiveness of any sanction except a bar or expulsion. Thus, the NAC's orders in the enclosed decision to pay fines will be stayed pending appeal.

Questions regarding the appeal process may be directed to the Office of the Secretary at the SEC. The phone number of that office is (202) 551-5400.

If you do not appeal, the fines ordered by the NAC may be paid after the 30-day period for appeal to the SEC has passed. Any fines and costs assessed should be paid (via regular mail) to FINRA, P.O. Box 7777-W8820, Philadelphia, PA 19175-8820 or (via overnight delivery) to FINRA, W8820-c/o Mellon Bank, Room 3490, 701 Market Street, Philadelphia, PA 19106.

Very truly yours,

Marcia E. Asquith
Senior Vice President and Corporate Secretary

cc: Leo Orenstein, Esq.