

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. C3A030024
	:	
v.	:	Hearing Officer – DMF
	:	
RICHARD S. JACOBSON	:	HEARING PANEL DECISION
(CRD #2326286)	:	
Tucson, AZ	:	January 23, 2004
	:	
	:	
Respondent.	:	

Respondent (1) exercised discretion in a customer’s account without written authorization, in violation of Rules 2510 and 2110; and (2) engaged in unethical conduct, in violation of Rule 2110, by falsely representing to his employer firm that he had failed to effect a sell order placed by the customer, in order to induce the firm to restore value to the customer’s account. For the unethical conduct, he is barred from associating with any NASD member in any capacity; in light of the bar, no additional sanctions are imposed for improperly exercising discretion.

Appearances

Roger D. Hogoboom, Esq., Denver, CO, (Rory C. Flynn, Esq., Washington, DC, Of Counsel) for Complainant.

Lindsay Brew, Esq., Tucson, AZ, for respondent.

DECISION

1. Procedural History

The Department of Enforcement filed a Complaint on June 26, 2003, charging that respondent Richard S. Jacobson (1) exercised discretion in the account of a customer without written authorization, in violation of Rules 2510 and 2110, and (2) engaged in unethical conduct, in violation of Rule 2110, by falsely representing to his employer that

he had failed to effect a sell order placed by the customer, in order to induce the firm to restore value to the customer's account. Jacobson filed an Answer in which he admitted the violations, but requested a hearing on the issue of sanctions. The hearing was held in Tucson, Arizona on December 8, 2003, before a Hearing Panel that included a Hearing Officer and two members of the District 3 Committee.¹

2. Facts

There was no dispute about the relevant facts. Jacobson has been in the securities industry since 1993. From 1993 to February 2002, he was registered with Salomon Smith Barney, Inc. ("SSB"), as a General Securities Representative. In March 2002, he became associated with Union Capital Company; he has been registered as a General Securities Representative with that firm since May 2002. He has no prior disciplinary history. (CX 1; Tr. 74-75, 120.)

In March 1998, JW opened an Individual Retirement Account at SSB with Jacobson as her registered representative. JW had been referred to Jacobson by her brother. She invested approximately \$5,000 in a Dow10 Unit Investment Trust (UIT), which she rolled over into a new Dow10 UIT in March 1999. Later in 1999, after her brother invested in an Internet UIT that performed well, JW also invested approximately \$4,700 of her IRA funds in the same Internet UIT, on Jacobson's recommendation. (CX 2.)

In January 2000, Jacobson induced JW to open a margin account, in which she invested approximately \$100,000 she had received as an inheritance. On Jacobson's recommendation, she invested the funds in an Internet UIT. JW subsequently also

¹ Enforcement offered the testimony of one witness and Complainant's Exhibits (CX) 1-10, which were admitted. Jacobson testified in his own behalf and called three other witnesses. He also offered Respondent's Exhibits (RX) 1-6, which were admitted.

purchased some stocks in her account, and in June 2000 she transferred additional holdings from an account at another firm to her SSB margin account. (CX 2.)

Jacobson admits that, beginning in approximately June 2000, he exercised discretion in trading JW's account. He acknowledges that from June through November 2000, "there were a large number of trades in [JW's] account. These trades were made without specific advance authority from [JW], and without written discretion."

According to Jacobson, JW's brother was trading his account very actively, and JW wanted to duplicate his trading patterns, but she was frequently out of town and unavailable to approve trades. Jacobson knew that the SSB manager for the region that included Jacobson's office generally did not permit registered representatives to exercise discretion in customer accounts, believing that discretionary accounts posed too great a risk to the firm. The only exception to this policy was for accounts under two SSB programs which required that the representatives be specially trained and follow strict investment guidelines, and that the accounts be closely monitored to ensure adherence to the guidelines. Jacobson knew that the type of speculative trading that JW wanted would not have been permitted under those programs. In spite of this, Jacobson agreed to and did engage in discretionary trading in JW's account, without written authorization from JW and without notifying SSB. (CX 2; Tr. 41-45, 75-77, 100-01, 116.)

Jacobson's trading led to a substantial margin balance in JW's account, which attracted the attention of Jacobson's branch management. In late 2000, the branch sent JW a letter noting the margin balance and corresponding interest charges, and asking JW to acknowledge that she had "been aware of all transactions in [her] account [and that the] transactions [met her] investment objectives and [had] been initiated with [her] full

knowledge and consent.” JW told Jacobson that she would not sign the letter because the account had not performed well and she had not specifically authorized all the trades in the account. According to Jacobson: “At this point, I panicked. In order to appease [JW], and in the hope of keeping my job, I suggested that I would inform [SSB] that she had given me a sell order for Internet UITs at a specific time when they had recouped much of an earlier loss, and that I had failed to carry out the order. It was my understanding that [SSB] would then reimburse her account for the difference and charge back the cost to me. This was done in February 2001. There was not a specific sell order at a specific time.” (CX 2, 4; Tr. 39-41, 84-86.)

In order to carry out this scheme, in February 2001 Jacobson met with his SSB branch manager and told him that JW had instructed him to liquidate her UIT holdings on September 22, 2000, but that he had forgotten to enter the order because he was leaving on vacation. Jacobson showed the branch manager an entry in his day-timer for September 22 that Jacobson had falsified to support his story. He told the branch manager that when he returned, he did not recall the order, and that JW did not realize he had failed to effect the order because she was caring for her ill mother and had not been opening her account statements and confirmations. Jacobson advised his branch manager that the market value of the UITs had diminished substantially since September, so their then-current value was approximately \$100,000 less than JW would have received if he had sold them on September 22, as JW instructed. According to the supervisor, Jacobson “stated emphatically that he knew it was his entire fault, but that he would like some time to pay for this error as he did not have the funds available to him.” (CX 2, 3, 5; Tr. 19-21, 105-06.)

Based on Jacobson's lie, SSB made a "trade error correction" in JW's account to reflect the sale of the UITs in September, which had the effect of adding approximately \$101,000 to the value of the account. Although SSB could have charged the full amount of the correction to Jacobson, his branch manager decided, "given his forthright admission of guilt and willingness to pay for his mistake," that the branch would contribute \$25,000. In addition, SSB allowed Jacobson to sign a note to SSB for the balance, approximately \$76,000, which provided that Jacobson could pay the note through payroll deductions over the following 18 months. (CX 2, 3, 6-10; Tr. 22-29.)

In January 2002, JW filed an arbitration claim against SSB, Jacobson and the branch manager, alleging unauthorized trading in her account. In her arbitration claim, JW included allegations regarding Jacobson's scheme. SSB questioned Jacobson about those allegations, but he insisted that they were untrue. In February 2000, however, the branch manager, Jacobson and SSB counsel attended a mediation involving an arbitration claim filed by JW's brother, who had also alleged unauthorized trading by Jacobson in his account. During the mediation, the brother's attorney, who also represented JW, told the branch manager, SSB counsel and Jacobson that JW had tape recorded her conversations with Jacobson about the scheme, and gave them copies of transcripts of the recordings. Upon seeing the transcripts, Jacobson confessed. In light of his confession, SSB concluded that it had little chance of defending JW's brother's claim, so it settled with the brother, paying him nearly \$140,000. SSB then terminated Jacobson, and entered into a settlement agreement with him, pursuant to which he reimbursed SSB the \$25,000, plus interest, that SSB had contributed to the payment to JW, as well as the balance due under the \$76,000 note Jacobson had given to SSB for his share of the

payment. Jacobson did not contribute to the settlement with JW's brother.² (CX 3, 10; Tr. 31-39, 47-49, 52-53, 70, 88, 103-05.)

3. Violations

Jacobson admits the violations charged in the Complaint. (Tr. 75-76.) The Hearing Panel, however, has independently considered the charges and finds that they are established by the undisputed facts. Rule 2510(b) provides:

No 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, as evidenced in writing by the member
....

Jacobson admits that he exercised discretion in JW's account; that he did not have written authorization from JW to exercise such discretion; and that, since he did not notify SSB that he was exercising discretion, SSB never authorized it. Accordingly, he violated Rule 2510(b), and by violating that rule, also violated Rule 2110's requirement that members and associated persons "observe high standards of commercial honor and just and equitable principles of trade."

Jacobson also admits that, when JW threatened to disclose to SSB that he had been exercising discretion in her account, "[i]n order to appease [her], and in the hope of keeping [his] job," he concocted a scheme to induce SSB to add value to her account. To accomplish the scheme, he lied to his branch manager and falsified his day-timer to provide evidence to support his lie. And although he initially agreed to take full responsibility for the payment to JW, when the branch manager, believing his story and giving him credit for his honesty, offered to pay \$25,000 of the amount, Jacobson

² Apparently JW has neither pursued nor settled her arbitration claim, and it remains pending. (Tr. 71.)

accepted it. Jacobson persisted in his lies until he was confronted with the transcripts of his conversations with JW.

In Department of Enforcement v. Shvarts, the National Adjudicatory Council explained the reach of Rule 2110:

Conduct Rule 2110 “is not limited to rules of legal conduct but rather ... it states a broad ethical principle.” ... Disciplinary hearings under Conduct Rule 2110 are ethical proceedings, and one may find a violation of the ethical requirements where no legally cognizable wrong occurred. ... The NASD has authority to impose sanctions for violations of “moral standards” even if there was no “unlawful” conduct.

No. CAF980029, 2000 NASD Discip. LEXIS 6, at *11 (NAC June 2, 2000) (citations and footnote omitted). As Jacobson concedes, his conduct was plainly unethical and therefore it violated Rule 2110.

4. Sanctions

Enforcement requested that, for exercising discretion in JW’s account without written authorization, the Hearing Panel fine Jacobson \$11,855.03 (which includes disgorgement of net commissions in the amount of \$1,855.03 attributable to his discretionary trading in JW’s account) and suspend him in all capacities for 30 days. For his unethical conduct in concocting and carrying out the scheme to induce SSB to add value to JW’s account, Enforcement requested that the Panel bar Jacobson from associating with any NASD member in any capacity. In contrast, Jacobson asked the Hearing Panel to impose, for his exercising discretion without written authorization, a fine of \$4,355.03 (including his commissions), but no suspension, and, for his unethical scheme, a \$10,000 fine and a 90-day suspension in all capacities.

The Sanction Guidelines for exercising discretion without written authorization recommend a fine of \$2,500 to \$10,000, plus the amount of the respondent’s financial

benefit from the transactions, and, in egregious cases, a suspension of 10 to 30 business days. NASD Sanction Guidelines (2001 ed.) at 94. The Guidelines list as principal considerations in determining sanctions for these violations (1) whether the customer's grant of discretion was express or implied, and (2) whether the firm's policies prohibited discretionary trading. In this case, Jacobson claimed that JW expressly granted him discretion to trade her account, and there is no evidence to the contrary. Jacobson knew, however, that in his region SSB did not permit discretionary accounts, except under two carefully defined and closely monitored programs. In spite of this, he agreed to exercise discretion in JW's account without written authorization and without notifying SSB. He made no effort to utilize SSB's authorized programs for discretionary accounts, knowing that the kinds of speculative trading that he would be undertaking in JW's account would not be allowed.

Under these circumstances, the Hearing Panel agrees with Enforcement that this was a highly egregious violation. The Panel concludes that the fine proposed by Enforcement would be appropriate, but that, notwithstanding the recommendations in the Guidelines, a suspension of at least 90 days would be required to fulfill NASD's remedial goals.³ Because the Hearing Panel will bar respondent for the other violation, however, additional sanctions for improperly exercising discretion would be redundant, and the Panel will not impose them.

For the scheme to reimburse JW, the parties suggested that there are no directly applicable Guidelines, but that it might be appropriate for the Panel to consider the Guidelines for falsification of records, by analogy. See NASD Sanction Guidelines

³ The Sanction Guidelines instruct that "[t]he recommended ranges in these guidelines are not absolute. ... Adjudicators may determine that egregious misconduct requires the imposition of sanctions above or otherwise outside of a recommended range." NASD Sanction Guidelines (2001 ed.) at 5.

(2001 ed.) at 43. The Hearing Panel agrees that there are no directly applicable Guidelines, but concludes that, because Jacobson’s misrepresentations to his branch manager were at the heart of his scheme, the Guidelines for intentional misrepresentations are the most appropriate analogy. Those Guidelines recommend a fine of \$10,000 to \$100,000 and a suspension for 10 days to two years, or, in egregious cases, a bar. Sanction Guidelines at 96.

The circumstances of this case are highly egregious. Jacobson made up an elaborate lie, and falsified his day-timer to support it, in order to cover up his improper discretionary trading in JW’s account. Although he claims that he expected that the full amount of the “correction” would be charged to him, when his branch manager offered to have the branch pay \$25,000 of the total, he accepted it. He also solicited a loan from SSB to fund the balance. When JW filed her arbitration claim disclosing the scheme, he continued to lie. He confessed only when confronted with transcripts his conversations with JW that made it impossible to continue to deny his misconduct.

Looking to the Principal Considerations in setting sanctions set forth in the Guidelines, the Panel notes (1) Jacobson did not acknowledge his scheme until the firm learned of it through the transcripts of the telephone conversations; (2) he attempted to conceal his misconduct from the firm; (3) his misconduct caused direct and substantial injury to the firm; (4) his misconduct was intentional; and (5) his misconduct resulted in monetary gain for him. All of these circumstances are highly aggravating. See Sanctions Guidelines at 9-10.

In mitigation, Jacobson argued that (1) his misconduct was “an isolated act in a long career without prior blemish”; (2) his scheme “was designed not to harm but to help

his customer by allowing her to recover from a market loss”; (3) he was fired by SSB, which, he argues, constitutes discipline by the firm that can be considered in mitigation of discipline by NASD; and (4) he cooperated in NASD’s investigation. He also cited a number of NASD decisions as possible support for the sanctions he proposed.⁴

None of the circumstances cited by Jacobson, however, is truly mitigating. His scheme may have been an isolated instance, but it was carefully conceived and implemented by Jacobson in response to a perceived threat to his livelihood that, in turn, was attributable to his misconduct in exercising discretion in JW’s account. His scheme was primarily designed to save himself from being fired, and he pursued it at the expense of his employer. His firing by SSB was not the sort of disciplinary action that could be considered in mitigation; it was the natural consequence of being caught in a lie. When he was fired, Jacobson moved to another NASD member, where he continues to function as a registered representative. And although he cooperated with NASD’s investigation by, for example, providing a written statement of the relevant facts, he merely acknowledged the misconduct that he was forced to admit when the transcripts appeared. There is little doubt that if JW had not recorded the conversations, Jacobson would have continued to lie.

Under these circumstances, the Hearing Panel concludes that the appropriate sanction is a bar.

⁴ Jacobson relied in particular on the sanctions imposed by the Hearing Panel in Department of Enforcement v. Greer, No. C05990035 (Nov. 6, 2000), but on review, the National Adjudicatory Council increased the suspension element of those sanctions substantially. 2001 NASD Discip. LEXIS 34 (Aug. 6, 2001). In any event, the sanctions in this case must be based upon an assessment of Jacobson’s misconduct, which differed significantly from the misconduct in the various cases he cited, including Greer.

5. Conclusion

Respondent Richard S. Jacobson (1) exercised discretion in a customer's account without written authorization, in violation of Rules 2510 and 2110; and (2) engaged in unethical conduct, in violation of Rule 2110, by falsely representing to his employer firm that he had failed to effect a sell order placed by the customer, in order to induce the firm to restore value to the customer's account. For the unethical conduct, he is barred from associating with any NASD member in any capacity; in light of the bar, no additional sanctions are imposed for improperly exercising discretion. In addition, respondent is ordered to pay costs in the amount of \$1,277.84, which includes an administrative fee of \$750 and hearing transcript costs of \$527.84. The bar shall become effective immediately if this decision becomes NASD's final disciplinary action in this matter.⁵

HEARING PANEL

By: David M. FitzGerald
Hearing Officer

Copies to:

Richard S. Jacobson (via overnight and first class mail)
Lindsay Brew, Esq. (via facsimile and first class mail)
Roger D. Hogoboom, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)

⁵ The Hearing Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.