

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

MICHAEL G. GRIMES
(CRD No. 2859084),

Memphis, TN

and

Memphis, TN,

Respondent.

Disciplinary Proceeding
No. C05010033

Hearing Officer—Andrew H. Perkins

Hearing Panel Decision

March 25, 2002

Respondent (1) converted customer funds to his own use and benefit, in violation of NASD Conduct Rules 2110 and 2330(a), and (2) failed to respond to three requests for information issued by NASD Regulation staff pursuant to NASD Procedural Rule 8210, in violation of NASD Conduct Rule 2110 and NASD Procedural Rule 8210. Respondent is barred from association with any member firm in any capacity for each violation.

Appearances

Ralph J. Veth, Regional Counsel, New Orleans, LA, and Rory C. Flynn, Chief Litigation Counsel, Washington, DC, for the Department of Enforcement.

Michael G. Grimes appeared on his own behalf.

DECISION

I. INTRODUCTION

The Department of Enforcement (“Department”) filed the two-cause Complaint in this proceeding on July 20, 2001, alleging in the first cause that Michael G. Grimes (“Grimes” or the “Respondent”) violated NASD Conduct Rules 2110 and 2330(a) by converting to his own use and benefit funds belonging to customer RG. The second cause of the Complaint alleges that Grimes violated NASD Conduct Rule 2110 and NASD Procedural Rule 8210 by failing to respond to three requests for information sent to him by NASD Regulation staff pursuant to NASD Procedural Rule 8210. On November 27, 2001, Grimes filed a letter that addressed the allegations in the Complaint and requested a hearing.¹ The Hearing Officer accepted the letter as his Answer. In his Answer, Grimes admitted that RG had given him a \$323 check payable to the order of “AMFLIC” (American Franklin Life Insurance Company) (referred to as “American Franklin Life”) in payment of the initial premium on a variable life insurance policy. Grimes claimed, however, that the check was insufficient to cover the premium due, so Grimes deposited the check into a “business account with the intent to make up the difference personally.” Grimes stated that he did this to help RG, who is the son of one of his good friends. As to the second count, Grimes claimed that he did not receive the information requests although his father had signed the receipt for one of them.

A Hearing Panel composed of the Hearing Officer and two current members of the District 5 Committee held the hearing in this matter on February 5, 2002, in Memphis,

¹ Originally, Grimes defaulted by failing to respond to the Notice of Complaint and Second Notice of Complaint within the time required by the NASD Code of Procedure. Upon receiving a copy of the

TN. The Department called two witnesses to testify and introduced 11 exhibits into evidence.² The witnesses were Sander J. Ressler, Vice President and Chief Compliance Officer at Franklin Financial, and Denise M. Labat, Special Investigator with NASD Regulation. Grimes testified in his defense, but offered no other evidence.

For the reasons discussed below, the Hearing Panel finds that Grimes violated NASD Conduct Rule 2110 and NASD Procedural Rule 8210, as alleged in the Complaint, and bars him from associating with any member firm in any capacity.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. The Respondent

According to the Central Registration Depository (“CRD”),³ Grimes entered the securities industry in 1997 with Duncan-Williams, Inc. Grimes first registered as a General Securities Representative on May 22, 1997.⁴ In February 1999, Grimes joined Franklin Financial Services Corporation (“Franklin Financial”), an NASD member firm and a wholly-owned subsidiary of American Franklin Life.⁵ Grimes was registered as a General Securities Representative at Franklin Financial from June 15, 1999, until May 10, 2000. Franklin Financial discharged Grimes on May 3, 2000, following its investigation of customer RG’s complaint that Grimes misappropriated his funds.⁶ During the same period,

Department’s Motion for Entry of Default Decision, Grimes moved for leave to file a late answer. The Hearing Officer granted the Respondent’s motion by order dated November 7, 2001.

² The hearing exhibits are referenced as: “CX- ____.” The hearing transcript is referenced as: “Tr. at ____.”

³ CX-1.

⁴ Id. at 5.

⁵ Id.; Tr. at 13.

⁶ CX-1, at 6.

he also was an insurance agent for American Franklin Life.⁷ Grimes has not worked in the securities industry or been registered with the NASD since May 10, 2000.⁸

B. Jurisdiction

NASD Regulation has jurisdiction over this proceeding under Article V, Section 4 of the NASD By-Laws, which provides that formerly registered persons remain subject to the NASD's jurisdiction for two years following the filing of a Uniform Termination Notice for Securities Industry Registration (Form U-5). During this period of retained jurisdiction, the NASD may file a Complaint based on the respondent's misconduct while registered, or based upon the respondent's failure to provide information requested pursuant to NASD Procedural Rule 8210 during the two-year period of retained jurisdiction. Here, the Complaint alleges misconduct that occurred while Grimes was registered at Franklin Financial and failures to respond to requests for information issued within two years of May 10, 2000, the effective date Grimes's last registration terminated. Further, the Department filed the Complaint on July 20, 2001, which was within two years from the effective date his registration terminated. Accordingly, the NASD has jurisdiction over this proceeding.

C. Conversion of Funds—First Cause of Complaint

In December 1999, Grimes received an application from RG to purchase a variable universal life insurance policy from American Franklin Life.⁹ Grimes does not contest the fact that he accepted the application and forwarded it to American Franklin Life for approval. Once American Franklin Life issued the policy, Grimes went to RG to collect

⁷ CX-1, at 4.

⁸ CX-1.

the initial premium payment, which was approximately \$423.¹⁰ Grimes testified, however, that when he went to collect the initial premium payment from RG, he had written the check for just \$323. According to Grimes, RG told him that he did not have the balance.¹¹ Nevertheless, Grimes accepted the payment and delivered the policy to RG.

Grimes testified that he took the check with the intent to make up the difference from his personal funds. According to Grimes, he was willing to do this for two reasons. First, Grimes wanted to help RG, who was his friend's son. Second, Grimes wanted to help himself. He implied that obtaining this new business would help him earn a company paid trip.

Grimes testified that his "initial plan" had been to cash the check and then borrow the premium shortage from his girlfriend.¹² To carry out this plan, Grimes had his girlfriend endorse RG's check and present it for payment at her bank. The bank, however, refused to cash the check, so Grimes resorted to an alternative plan.¹³ He crossed out his girlfriend's endorsement and forged American Franklin Life's endorsement himself. He then deposited the check into a bank account belonging to his father's business.¹⁴ Grimes claimed that although he did not have authority to write checks on this account, he had his commission

⁹ CX-4, at 2.

¹⁰ Tr. at 41.

¹¹ Id.

¹² Id. at 42.

¹³ Id. The Hearing Panel notes that the Respondent's testimony varied from the account he gave Franklin Financial. During its investigation of RG's complaint, Grimes told Ressler and the company's legal counsel that the reason he crossed out his girlfriend's endorsement was that she changed her mind and refused to go through with his plan to cash the check. (CX-7, at 2.)

¹⁴ Id. at 45.

checks from Franklin Financial direct deposited to the account.¹⁵ Upon questioning by the Hearing Panel, he offered that the reason he did this was to insulate his money from the claims of his ex-wife.¹⁶

Grimes further testified that his plan was to wait until he received his next commission check from Franklin Financial and then forward the premium payment to American Franklin Life. Grimes did not have sufficient funds in the account at the time to enable him to send the payment immediately. But, before he could complete his plan, RG complained to American Franklin Life that his check had been endorsed and cashed by Grimes.¹⁷ Franklin Financial terminated Grimes after it received a request for information from NASD Regulation.

Ressler, Chief Compliance Officer at Franklin Financial, testified that he investigated RG's complaint. Shortly after receiving the complaint, Ressler conducted a conference call on April 3, 2000, among himself, Grimes, and the firm's legal counsel.¹⁸ During the call, Grimes admitted that he received the check from RG, endorsed it with American Franklin Life's name although he was not an authorized endorser, and deposited it into his business account.¹⁹ Grimes claimed that his father mailed the full premium payment to American Franklin Life on March 27, 28 or 30, 2000.²⁰ However, Ressler

¹⁵ Id.

¹⁶ Id. at 46.

¹⁷ CX-6, at 1; CX-7, at 1.

¹⁸ Tr. at 18.

¹⁹ Id. at 21-22.

²⁰ CX-7, at 1.

testified that American Franklin Life never received the payment and that Grimes never repaid American Franklin Life the \$323 it paid to RG in reimbursement of his loss.²¹

Upon consideration of all the evidence, and having had the opportunity to observe the Respondent's demeanor at the hearing, the Hearing Panel finds that the Respondent's account lacks credibility. Grimes's story that he had his girlfriend attempt to cash the check so that he could borrow \$100 from her and send the premium payment to American Franklin Life is incredible and lacks corroboration.²² Grimes offered no explanation of his need to cash RG's check, where he instead could have borrowed the additional money from his girlfriend and forwarded it with the check. Likewise, if he needed to wait until he received his commission check from Franklin Financial before he could make up the premium payment shortfall, he could have held RG's check until he had the missing money. Grimes offered no explanation why he felt it was necessary to deposit the check into an account he controlled.²³

In summary, the Hearing Panel finds that Grimes intended to cash RG's check for his own use and benefit, not to assist RG. Furthermore, the Hearing Panel finds that Grimes has not repaid the money to American Franklin Life. Accordingly, the Hearing

²¹ Id. at 24.

²² His testimony also is contradictory to the story he gave Franklin Financial.

²³ Although Grimes claimed that he lacked authority to write checks on this account, the Hearing Panel finds that he was a beneficial owner of the account. Grimes admits that he had his commission checks deposited directly to the account and that he used the account to avoid having his funds subject to his ex-wife's claims. Under these circumstances, the business account functioned as his personal checking account.

Panel finds that Grimes violated NASD Conduct Rule 2110 by converting the sum of \$323 belonging to RG.²⁴

D. Failure to Respond to Information Requests—Second Cause of Complaint

The Complaint also charges that Grimes failed to respond to three NASD Regulation requests for information pursuant to Rule 8210. Grimes contended that he did not respond to the first two requests because he did not receive them, and he had no excuse for not responding to the third request.

NASD Regulation staff opened an investigation after Franklin Financial filed a Form 3070 on April 13, 2000, disclosing that Grimes had been suspended pending an investigation of a customer complaint alleging misappropriation of funds.²⁵ On May 16, 2000, NASD Regulation staff sent a request, pursuant to Rule 8210, by certified and first-class mail to Grimes at his residential address as listed in the CRD.²⁶ NASD Regulation staff asked Grimes to supply information about his relationship with RG and the disposition of RG's check.²⁷ The US Postal Service returned the certified mailing to

²⁴ The Complaint also charges that Grimes's conversion of funds violated Rule 2330(a), which applies to "improper use of a customer's securities or funds." The application of that Rule is unclear, however, in these circumstances. The Rule applies to misuse of funds of customers of an NASD member firm. It does not appear however that RG had a pre-existing relationship with Franklin Financial, and it is not clear that he intended to become a customer of that firm; instead, he intended to purchase a variable life insurance product from American Franklin Life. While it appears that the policy may be a securities product, there is no evidence that this particular product had to be sold through Franklin Financial, a registered broker-dealer. Accordingly, the Hearing Panel rests its decision in this case on Rule 2110, which applies regardless whether RG is treated as a customer of Franklin Financial or American Franklin Life, or whether the policy he intended to purchase can be classified as a securities product. See, e.g., District Bus. Conduct Comm. v. Shegon, No. C9A960030, 1997 NASD Discip. LEXIS 66, *5 (NBCC Nov. 20, 1997).

²⁵ CX-3.

²⁶ Tr. at 31.

²⁷ CX-9.

NASD Regulation staff with the notation that it was unclaimed. The first-class mailing was not returned.²⁸

When Grimes did not respond to the May 16 request, NASDR staff sent a follow-up letter on June 20, 2000.²⁹ NASD Regulation staff also sent this letter by certified and first-class mail addressed to Grimes at his CRD address pursuant to NASD Procedural Rule 8210. The June 20 letter requested the same information as the first request for information. The Postal Service did not return either mailing, but it did return the unsigned receipt for the certified mailing.³⁰

On July 11, 2000, NASDR staff sent Grimes another request for information pursuant to Rule 8210.³¹ As with the other two requests, NASD Regulation staff sent this letter by certified and first-class mail addressed to Grimes at his CRD address.³² The Postal Service returned the receipt for the certified mailing signed by “Ray Grimes.”³³ The Postal Service did not return the first-class mailing.

On July 28, 2000, Grimes telephoned NASD Regulation staff and spoke to Labat. He indicated that he had received her July 11 letter and asked if he could have some additional time to respond. Labat granted his request, but he never supplied the information or requested additional time to respond.³⁴

²⁸ Tr. at 31.

²⁹ CX-10.

³⁰ Tr. at 33.

³¹ CX-11.

³² Tr. at 34.

³³ Id.; CX-11.

³⁴ Tr. at 35.

Grimes excuses his non-compliance with the first two requests on the ground that he did not receive them. Grimes speculated that his father may have received the letters and failed to give them to him. According to Grimes, he had been having trouble with his father intercepting his mail for the entire three years that they had been living together.³⁵ As to the final request for information, Grimes's only excuse is that he thought the papers he sent months later in response to the Complaint were adequate.³⁶ None of these excuses is sufficient. Grimes had an unqualified obligation to respond to the staff's requests for information. Grimes cannot free himself of this obligation by relying on his own negligence.

Accordingly, the Hearing Panel finds that Grimes violated NASD Conduct Rule 2110 and NASD Procedural Rule 8210 for failing to respond to the three requests for information.³⁷ Grimes received constructive notice of the first two requests³⁸ and actual notice of the third, yet he failed to produce any of the information NASD Regulation staff sought.

³⁵ Tr. at 49-50.

³⁶ Id. at 64.

³⁷ See Brian L. Gibbons, 52 S.E.C. 791 (1996), aff'd, 112 F.3d 516 (9th Cir. 1997) (holding that person violates Rule 8210 when he fails to provide full and prompt cooperation when a request for information and documents is made); Joseph Patrick Hannan, 53 S.E.C. 854 (1998) (holding that a violation of Rule 8210 constitutes a violation of Conduct Rule 2110).

³⁸ Grimes had constructive notice of the first two requests because NASDR staff served them in strict accordance with the notice provisions of NASD Procedural Rule 8210. Rule 8210(d) provides in relevant part that "[a] notice under this Rule shall be deemed received by the member or person to whom it is directed by mailing or otherwise transmitting the notice to the last known business address of the member or the last known residential address of the person as reflected in the Central Registration Depository."

III. SANCTIONS

A. Conversion

The Hearing Panel finds that the appropriate remedial sanction for the Respondent's conversion of funds is a bar.³⁹ The evidence establishes that Grimes concocted two schemes to misappropriate \$323 from RG. First, he tried to get his girlfriend to cash the check. When that failed, he forged American Franklin Life's endorsement and deposited the check to an account he controlled. Grimes has made no effort to repay the money he took, and he continues to refuse to accept responsibility for his misconduct. Moreover, there are no mitigating factors warranting any less stringent sanction. Accordingly, the Hearing Panel will bar Grimes from associating with any member firm in any capacity for conversion of customer funds.

B. Failure to Respond to Request for Information

Failure to comply with a request for information under NASD Procedural Rule 8210 is a serious offense because it subverts the NASD's ability to perform its regulatory duties.⁴⁰ Accordingly, the applicable NASD Sanction Guideline recommends that a respondent who fails to respond in any manner should be barred from the industry.

Here, the Hearing Panel also finds that Grimes should be barred for his failure to respond to NASD Regulation staff's Rule 8210 requests for information. Grimes presented no justification for his failure to provide the information requested, and there are no mitigating facts in the record that would support a less stringent sanction. Grimes

³⁹ The NASD Sanction Guidelines for conversion recommends that a bar be standard in all cases. See NASD Sanction Guidelines 42 (2001 ed.).

⁴⁰ Department of Enforcement v. Baxter, No. C07990016, 2000 NASD Discip. LEXIS 3, at *25 (NAC Apr. 19, 2000).

acknowledged receipt of the third request, and then ignored it. In summary, Grimes demonstrated a total disregard for his obligations under Rule 8210. Accordingly, the Hearing Panel will bar Grimes from associating with any member firm in any capacity for his failure to respond to the three requests for information.

IV. ORDER

Michael G. Grimes is barred from association with any NASD member firm in any capacity for converting customer funds in violation of NASD Conduct Rule 2110, and for failing to respond to requests for information, in violation of NASD Conduct Rule 2110 and NASD Procedural Rule 8210.⁴¹ These bars will become effective immediately upon this Decision becoming the final disciplinary action of the NASD.

Grimes also is ordered to pay costs in the total amount of \$1,448.05, which include an administrative fee of \$750 and hearing transcript costs of \$698.05.

Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

Michael G. Grimes (by FedEx, next day delivery, and first-class mail)
Ralph J. Veth, Esq. (by first-class and electronic mail)
Rory C. Flynn, Esq. (by first-class and electronic mail)

⁴¹ The Hearing Panel 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.