NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. SCOTT WIARD (CRD #1509365) 5485 Merritt Road Ypsilanti, MI 48197 JAMES REISINGER (CRD #1275258) 7090 Chamberlin Dexter, MI 48130 Respondents.	Disciplinary Proceeding No. C8A030078 Hearing Officer – DMF **HEARING PANEL DECISION** May 25, 2004

Respondents violated Rule 2110 by using discretionary authority to invest client funds in a manner that the clients did not authorize, and that Respondents did not determine was suitable for the clients. For these violations, Respondents are barred from association with any NASD member in any capacity. Respondent Wiard also violated Rule 2110 by maintaining discretionary accounts, contrary to conditions imposed on him by NASD when it approved a Membership Continuance Application filed on his behalf, and by failing to disclose customer complaints on his Form U-4. In light of the bar, no additional sanctions are imposed on him for these violations.

Appearances

Kevin G. Kulling, Esq., Chicago, IL, (Rory C. Flynn, Esq., Washington, DC, Of Counsel) for Complainant.

Edmund J. Sikorski, Jr., Esq., Ann Arbor, MI, for Respondents.

DECISION

I. Procedural History

The Department of Enforcement filed a Complaint on October 13, 2003, charging that (1) Respondents Scott Wiard and James Reisinger used their discretionary authority to invest clients' funds in a manner that (a) the clients did not authorize, in violation of Rule 2110, and (b) was unsuitable for the clients, in violation of Rules 2110 and 2310, as well as IM-2310-2; (2) Wiard maintained discretionary accounts, which was prohibited under conditions that NASD imposed on him when it approved a Membership Continuance Application filed on his behalf, in violation of Rule 2110; (3) Wiard failed to update his Uniform Application for Securities Industry Registration or Transfer (Form U-4) to disclose certain customer complaints, in violation of Rule 2110; and (4) Respondents violated Rules 2110, 2210 and 3010 in various respects through the distribution of certain sales literature and violated Rule 2210 through the distribution of a certain letter.

Respondents filed an Answer contesting the charges and requested a hearing, which was held in Ann Arbor, Michigan on March 23 and 24, 2004, before a Hearing Panel that included a Hearing Officer and two members of the District 8 Committee. At the outset of the hearing, Enforcement voluntarily withdrew the last charges, concerning the alleged distribution of sales literature and a letter, and the hearing proceeded as to the remaining charges.[1]

[1] At the hearing, Enforcement presented the testimony of six witnesses, including Respondent Wiard, and offered Complainant's Exhibits (CX) 1-7 and 10-32, all of which were admitted. Respondents presented the testimony of respondent Wiard and Respondents' Exhibits (RX) 1-1 through 1-8, 2-1 and 2-2, and 3-1 through 3-3, all of which were admitted.

II. Respondents And The SJT Program

From 1989 to 2002, Respondents were associated with NASD member Royal Alliance Associates, Inc. During this period, they were registered as both General Securities Principals and General Securities Representatives. At the same time, Respondents owned and operated Horizons Planning Corporation, an investment advisor registered with the state of Michigan. Respondents' Horizons clients were also Royal Alliance customers; thus, Respondents wore two hats, serving their clients both as registered representatives of broker-dealer Alliance and as representatives of investment advisor Horizons. (CX 1, 2; Tr. 14, 16-17, 73, 83-84.)

For the majority of their Horizons clients, Respondents recommended and implemented a market timing investment strategy they referred to as the Strategic Journal Transfers, or SJT, program.[2] The SJT program rested on Respondents' theory that, because corporate retirement plans generally make large investments on behalf of their employees at the end of each month, the period around month's end is the optimal, least risky time to be invested in equities.[3] Therefore, the SJT strategy was to hold clients' investments in money market funds during most of each month, but to transfer ("journal") the clients' entire investments into equities for a fairly brief time period around the end of the month. (Tr. 25-30, 40, 54-60, 300-03; CX 5-7.)

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[2] At the relevant time, Wiard had about 100 clients, 60 to 70 of whom were in the SJT program, and Reisinger had about 200 clients. Most of the clients who were not in the SJT program were either insurance-only clients or one-time investors who had a lump sum or rollover that they invested in mutual funds or annuities. (Tr. 21-23.)

[3] In addition, Respondents employed certain "seasonality" theories in the SJT program, such as that corporations most often try to announce bad performance news at certain times of the year, making equities investments at those times riskier. (Tr. 43-44.)

Furthermore, when the clients were invested in equities, Respondents' SJT strategy sought "highly volatile" funds, on the theory that, because the clients were invested in equities for only a brief, favorable period each month, high volatility was likely to maximize the clients' return on their investments. Respondents believed – and advised their clients – that, by keeping their clients' funds in money markets for most of each month and putting them in volatile equity funds for only relatively short periods, the SJT program would expose the clients to only moderate overall investment risk (Tr. 26-28, 35-36.)

To enter the SJT program, the majority of Respondents' SJT clients (about two-thirds) purchased variable annuities, while the balance invested in mutual funds.[4] In either case, each client gave Horizons a written "Authorization for Discretionary Accounts" to manage their investments; in addition, they opened non-brokerage accounts with Royal Alliance through which the variable annuities or mutual funds were purchased. (Tr. 30-33, 38-39, 82-84; CX 5.)

Using their discretion, Respondents implemented the SJT strategy by moving their clients' funds back and forth between conservative money markets and volatile equities. Respondents moved the funds of the clients who were invested in variable annuities between variable annuity sub-accounts, utilizing a money market sub-account and two equities sub-accounts, one designed to track the S&P 500 Index on a leveraged basis (150%), and the other designed to track the NASDAQ 100 Index on a leveraged

[4] Wiard explained that the variable annuity was Respondents' "number one choice … because of the convenience and accessibility of information that's available to us. There are some circumstances where the variable annuity is not appropriate for the client. Someone who wants regular withdrawals, at least initially from the contract, there's tax consequences." (Tr. 68.)

basis (200%).[5] Respondents moved the funds of the clients who were invested in mutual funds between a money market fund and equities growth funds, because leveraged index-based mutual funds were not available. Regardless of whether they utilized variable annuity sub-accounts or mutual funds to effectuate the SJT strategy, at any given time Respondents invested their clients' SJT program funds either 100% in money markets or 100% in equities, and they moved all of their clients back and forth between money markets and equities at the same time. Thus, for purposes of implementing the SJT strategy, Respondents treated all of their clients alike, without regard to their individual circumstances. Respondents recognized that they had an obligation to make an individualized suitability determination for each client, but did so by determining how much of each client's total assets were appropriate for the SJT program, rather than by tailoring the SJT program to each client. (Tr. 30, 33, 87-90, 279-81.)

III. Unauthorized Transactions/Suitability

By September 2000, as a result of a downturn in the market that began earlier in 2000, Respondents' SJT program participants had lost substantial value in their accounts. On September 30, 2000, Respondents invested all of their SJT clients' funds in equities, in accordance with the SJT strategy. Respondents did not, however, move their clients' investments back into money market funds in early October, or at any time thereafter, in accordance with the SJT theory. Instead, they left the clients fully invested in the equities

[5] The clients purchased the variable annuities from American Skandia Life Assurance Corporation. When Respondents moved their clients' funds from an American Skandia money market sub-account into equities, they invested 50% of the clients' funds in a "ProFund VP Bull Plus" sub-account that sought daily investment results corresponding to one and a half times the daily performance of the S&P 500 and 50% in a "ProFund VP UltraOTC" sub-account that sought daily investment results corresponding to two times the daily performance of the NASDAQ 100 Index. American Skandia "recommended that only those Owners who engage a financial advisor to allocate their funds in strategic or tactical asset allocation strategies invest in these [sub-accounts]." (Tr. 34-35, 41-42, 66; CX 32 at 23.)

sub-accounts or mutual funds, without advising the clients that they had changed investment strategies. (Tr. 264, 270, 283-84.)

Wiard insisted that Respondents did not abandon the SJT strategy. He pointed out that the SJT program was not entirely mechanical; Respondents determined each month when to move their clients from money markets to equities and when to return to money markets. Some months they elected not to move the clients into equities at all, and sometimes when they did move the clients into equities near the end of a month, they did not move them back into money markets early in the following month. Wiard testified that after September 30, 2000, Respondents considered on a daily basis whether the time was right to move their clients' funds out of equities and back into money markets. He acknowledged, however, that from September 30, 2000 up to the date of the hearing, Respondents had never found the time right for such a move. Instead, throughout this entire period, unless a client instructed otherwise, Respondents left their clients fully invested in the equities sub-accounts or mutual funds into which their funds had been transferred, in accordance with the SJT strategy, in September 2000. In doing so, Respondents did not determine for each individual client that leaving that client fully invested in equities was suitable; instead, they treated all of their pre-September 2000 clients alike, leaving all of them fully invested in volatile equities sub-accounts or mutual funds. (Tr. 263-66, 278-79.)

During the same time period, however, Respondents continued to follow the SJT timing strategy for clients who invested after September 2000. Respondents still kept those clients' funds invested primarily in money market funds, moving the funds into equities for only brief periods before transferring them back to money markets –

precisely the same SJT strategy that Respondents had followed for their other clients before September 2000. Respondents invested their pre- and post-September 2000 clients' funds differently not based on the SJT strategy, but based on the losses that the pre-September 2000 clients had suffered. For those clients, Respondents concluded that the best strategy was to leave their funds fully invested in volatile equities sub-accounts or mutual funds until the market rebounded and the clients recaptured their losses. Unfortunately, as of the date of the hearing, that had still not occurred. (Tr. 268-71, 275-76, 312-14, 319.)

Enforcement argued that Respondents' decision not to follow the SJT timing strategy after September 2000 was unauthorized, and therefore violated Rule 2110. The Hearing Panel agrees. Respondents' clients all identified themselves as seeking "moderate" investment risk. Respondents believed, and advised the clients, that because the funds would be invested in equities for only relatively brief periods, when prospects for market gains were greatest, the SJT program was a moderate risk investment. Moreover, they believed, and told their clients, that because the funds would be invested in equities only during these brief, favorable periods, highly volatile equities sub-accounts and mutual funds were consistent with the clients' desired moderate risk level.

After September 2000, however, Respondents left their clients fully invested in the volatile equity sub-accounts and mutual funds, without regard to the market timing theories underlying the SJT program, a strategy that can only be described as high-risk and speculative. Whether the new strategy was better or worse than the SJT strategy is irrelevant; it was manifestly different, and the difference was plainly material. Wiard himself believed that the clients investments "would have a much higher risk" if

Respondents left them fully invested in equities, rather than moving back and forth between equities and money markets as contemplated under the SJT program. (Tr. 304.) Nevertheless, Respondents failed to seek or obtain their clients' authorization for this change in investment strategy.

The Hearing Panel concludes that Respondents thereby violated Rule 2110, which requires that NASD members and associated persons observe high standards of commercial honor and just and equitable principles of trade. In Department of Enforcement v. Shvarts, the National Adjudicatory Council (NAC) 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).

It is well settled that conduct violates Rule 2110 "if the surrounding facts and circumstances indicate that the conduct was unethical. The concepts of excuse, justification and 'bad faith' may be employed to determine whether conduct is unethical in these cases." Shvarts, 2000 NASD Discip. LEXIS 6 at *13. The NAC recently explained:

> The SEC has construed Conduct Rule 2110 broadly to apply to all business-related misconduct, regardless of whether the misconduct involved securities. . . . The principal consideration is whether the misconduct reflects on an associated person's ability to comply with regulatory requirements necessary to the proper functioning of the securities industry and protection of the public. . . .

Department of Enforcement v. Davenport, No. C05010017, 2003 NASD Discip. LEXIS 4, at *8-9 (May 7, 2003) (Citations omitted).

Respondents' actions violated Rule 2110 under the above standards. Respondents knew that, in light of their clients' losses, they had changed their strategy, but they chose not to disclose that to the clients. There was no excuse for that failure. Even if Respondents did not consciously decide to alter their strategy immediately, certainly by the time a few months had elapsed they knew they were no longer following the SJT plan; instead, they were speculating in high risk investments in a desperate effort to recoup their clients' losses. Furthermore, the fact that they had abandoned the SJT strategy for their pre-September 2000 clients must have been clear to them, because they continued to implement the SJT market timing approach for their post-September 2000 clients.

Wiard testified that Respondents thought about notifying their clients of the change in strategy with individual letters or a newsletter, but did not do that: "A newsletter would say you've been in the market, we're still in the market today and we don't have any idea when we're going to get out. I mean, I guess with the heading of good communication that would have worked, but we didn't feel it was prudent." (Tr. 311.) But while it might not have been "prudent," Respondents had an obligation to tell their clients that they were no longer following the SJT strategy. Those clients had enrolled in a market timing program that Respondents characterized as having only moderate risk, but, without telling the clients, Respondents had abandoned market timing, leaving the clients invested full time in volatile equity sub-accounts and mutual funds. Under these circumstances, Respondents' failure to notify their clients was in bad faith.

The Panel rejects Respondents' argument that the clients could have discovered the change in investment strategy by carefully reviewing the monthly statements they received. Having persuaded the clients to invest in the SJT program, Respondents had an affirmative ethical obligation to disclose that they were no longer following the market timing strategy they had described to the clients. For the same reason, the Panel rejects the argument that Respondents did not have to make a disclosure because the clients had given them written discretion to make investment decisions. Respondents solicited and the clients provided those authorizations to implement the SJT strategy. Therefore, they could not reasonably rely on those authorizations to effect a different approach.

The Hearing Panel, therefore, finds that Respondents violated Rule 2110 by making a material change in the investment strategy they were employing without their clients' authorization.

Enforcement also contended that Respondents violated Rules 2310 and 2110, as well as IM-2310-2, by failing to determine as to each individual client that leaving the client fully invested in volatile equities sub-accounts or mutual funds after September 2000 was suitable for the client.

Rule 2310 requires that before recommending to a customer the purchase, sale or exchange of any security, a member or associated person must have a reasonable basis for believing that the transaction is suitable for the customer, based on the customer's other securities holdings, financial situation and needs.[6] In this case, rather than recommending transactions, Respondents stopped making the transfers between equities

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[6] The obligation to recommend only suitable transactions extends to discretionary transactions, because "[w]hen a broker effects transactions in an account over which he has discretionary authority, the transactions are implicitly recommended." Department of Enforcement v. Lu, No. C9A020052 (NAC May 13, 2004).

and money markets that they had recommended to their clients as part of the SJT market timing strategy. Rule 2310, therefore, is not literally applicable, because there were no purchases, sales or exchanges.

As explained above, however, Rule 2110 has a broader reach. Even if Rule 2310 does not literally apply to Respondents' conduct, the underlying principle is applicable. When they changed their investment strategy from market timing under the SJT program to full time investment in volatile equity funds, Respondents had an obligation to determine that the change was suitable for each of their SJT clients. The suitability determinations that they made when the clients entered the SJT program were not sufficient to satisfy this obligation. First, those determinations were based on the SJT program, which the Respondents believed, and told their clients, was a moderate risk strategy; beginning in September 2000, however, they embarked on a strategy that even they recognized involved higher risk. Second, a suitability determination must be based on the customer's then-current circumstances, not circumstances that might have existed at an earlier time.

The Panel, therefore, finds that by failing to determine that their post-September 2000 strategy was suitable for each of their clients, Respondents violated Rule 2110.[7]

IV. Wiard's Use Of Discretionary Authority

In 1999, Wiard was convicted of a felony in Michigan; as a result, he was subject to a statutory disqualification, pursuant to Art. III, § 4(g)(2) of NASD's By-Laws. On or about May 20, 2000, Royal Alliance submitted a membership continuance application ("MC 400") requesting that NASD approve Wiard's continued association with Royal

[7] The Complaint also cites IM-2310-2, which addresses the obligation of "Fair Dealing with Customers" and, among other things, points out that effecting "[t]ransactions in discretionary accounts in excess of or without actual authority from customers" is inconsistent with that obligation.

Alliance under a heightened supervision plan. The NAC approved the request on behalf of NASD, subject to certain conditions, including that "Wiard will not maintain discretionary accounts." Pursuant to SEC Exchange Act Rule 19h-1, NASD notified the SEC of its MC 400 approval of Wiard's continued association with Royal Alliance, subject to the stated conditions, and the SEC approved NASD's notice on January 18, 2001. (CX 3.)

In spite of the conditions set forth in NASD's MC 400 approval, Wiard continued to exercise discretion over the investment decisions of the SJT program participants. He, along with Reisinger, determined whether and when to move the clients' money between sub-accounts or between mutual funds. Enforcement contends that this violated the "no discretionary accounts" condition of NASD's MC 400 approval.

Wiard argues that, for several reasons, the discretion he exercised over the SJT clients' investments did not violate the "no discretionary accounts" condition. He points out that he disclosed the SJT program to the NAC hearing panel that considered Royal Alliance's MC 400 application, and, therefore, argues that the NAC's subsequent approval of the application implied that it did not intend to prohibit him from exercising discretion in connection with that program. He also contends that the discretion he held to determine where and when to move clients' funds pursuant to the SJT program did not make them "discretionary accounts," as that term is commonly understood.

Wiard's arguments, however, are effectively foreclosed by a subsequent NAC decision. In April 2002, Wiard voluntarily terminated his association with Royal Alliance. In August 2003, another NASD member, Prestwick Securities, Inc., submitted an MC 400 application to permit Wiard to associate with it. The NAC denied

Prestwick's application, stating: "[W]e previously approved an application for Wiard to associate with a firm, which prohibited him from servicing discretionary accounts. In considering the current Application, we conclude that Wiard disregarded this condition and operated a discretionary, market-timing program for his customers while associated with a member firm." The NAC specifically considered and rejected Wiard's argument that the prohibition did not apply to the market timing switches used to effectuate the SJT program. Scott E. Wiard, No. SD-1601 (NAC Feb. 5, 2004), appeal pending, No. 3-11402 (SEC Feb. 24, 2004).

In light of the NAC's holding, the Hearing Panel finds that Wiard violated the "no discretionary accounts" condition.[8] Further, the Panel concludes that, by violating the condition, Wiard failed to "observe high standards of commercial honor and just and equitable principles of trade," as required by Rule 2110.

V. Wiard's Failure To Update His Form U-4

Every person applying to be registered with an NASD member must complete a Form U-4, and Art. V, § 2(c) of the NASD By-Laws requires that "[e]very application for registration filed with the NASD shall be kept current at all times . . . . Such amendment to the application shall be filed with the NASD not later than 30 days after learning of the facts or circumstances giving rise to the amendment." The registered representative bears ultimate responsibility for ensuring that his or her Form U-4 is updated, and it is well established that it is a violation of Rule 2110 for a representative to fail to do so. See Department of Enforcement v. Howard, No. C11970032, 2000 NASD Discip. LEXIS 16, at*31 (NAC Nov. 16, 2000), aff'd, 2002 SEC LEXIS 1909 (July 26, 2002).

[8] Even if the NAC had not ruled on the issue, the Panel would find that, at least as to the clients who were invested in mutual funds, Wiard's discretion to move those investments between funds violated the "no discretionary accounts" condition.

In this case, Enforcement alleged that Wiard failed to update his Form U-4 in a timely manner to reflect two customer complaints. There was no dispute about the relevant facts. The first complaint, from customer CB, was from October 2001, while the second, from two customers, both of whose initials were also CB, was sent in December 2001. Wiard never updated his U-4 to disclose the first complaint, and failed to update his U-4 regarding the second complaint until December 2003. (Tr. 113-14; CX 1.)

Wiard argued that he relied upon Royal Alliance to tell him whether to update his Form U-4, based on statements in the firm's compliance manual. This argument, however, was offered in mitigation of sanctions, rather than as a defense to the charge, since it is well established that "[t]he burden of updating a Form U-4 rests with the registered representative." Department of Enforcement v. Howard, 2000 NASD Discip. LEXIS 16, at*31. Acknowledging this principle, Wiard's counsel stated, "We're not disputing the liability issue." (Tr. 234.) Accordingly, the Hearing Panel finds that Wiard violated Rule 2110 by failing to update his Form U-4 in a timely manner.

VI. Sanctions

Turning first to Respondents' unauthorized change in their investment strategy and their failure to determine whether that change was suitable for each of their affected clients, the Hearing Panel looked to the Sanction Guidelines for unauthorized transactions and for suitability violations. For both unauthorized transactions and suitability violations, the Guidelines recommend a suspension of 10 business days to one year, or a longer suspension of up to two years or a bar in egregious cases. In addition, the unauthorized transactions Guidelines recommend a fine of $5,000 to $75,000, and the

suitability Guidelines recommend a fine of $2,500 to $75,000.[9] NASD Sanction Guidelines at 99, 102 (2001 ed.).

The Hearing Panel concludes that these violations were egregious. The unauthorized transactions Guidelines indicate that the National Adjudicatory Council has identified several categories of egregious misconduct: quantitatively egregious unauthorized trading (i.e., unauthorized trading that is egregious because of the sheer number of transactions); unauthorized trading accompanied by various aggravating factors; and qualitatively egregious unauthorized trading, marked by clear evidence of lack of authorization, or bad faith on the part of the respondent. In this case, Respondents' violation was both quantitatively and qualitatively egregious, because it involved a large number of clients over a long period of time, and qualitatively egregious because the evidence was clear and generally undisputed and because, as explained above, Respondents' actions were in bad faith.

With regard to suitability, the Panel finds the violation egregious based on several general considerations set forth in the Guidelines. Respondents have never acknowledged their misconduct; it involved many clients over an extended period; and it arose from Respondents' undisclosed decision to abandon the SJT program in the hope of recouping their clients' losses through a speculative investment strategy.

The Hearing Panel, therefore, concludes that the appropriate sanction is to bar Respondents from associating with any NASD member in any capacity.

Wiard's other violations would call for lesser sanctions. In light of the bar, however, such sanctions would be redundant and would serve no remedial purpose. See

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[9] Enforcement requested that Respondents be barred from associating with any NASD member, but offered the Hearing Panel no detailed analysis to support that recommendation. (Tr. 347.)

Jeffrey B. Hodde, No. C10010005, 2002 NASD Discip. LEXIS 4, at *17 (NAC Mar. 27. 2002). Therefore, the Hearing Panel will not impose any separate sanctions for those violations.

VII. Conclusion

Respondents Scott Wiard and James Reisinger used discretionary authority to invest client funds in a manner that the clients had not authorized, and that Respondents had not determined was suitable for the clients, in violation of Rule 2110. For these violations, Respondents are barred from associating with any NASD member in any capacity. In addition, Respondents, jointly and severally, are ordered to pay costs in the amount of $2,538.50, which includes an administrative fee of $750 and hearing transcript costs of $1,788.50.

Respondent Wiard also violated Rule 2110 by maintaining discretionary accounts, contrary to conditions imposed on him by NASD when it approved a Membership Continuance Application filed on his behalf, and by failing to disclose customer complaints on his Form U-4. In light of the bar, no additional sanctions are imposed on him for these violations.

If this decision becomes NASD's final disciplinary action in this matter, the bars shall become effective immediately.[10]

HEARING PANEL

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By: David M. FitzGerald
Hearing Officer

[10] 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.

Copies to:

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