SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64565 / May 27, 2011

Admin. Proc. File No. 3-13932

In the Matter of the Application of

RICHARD G. CODY
c/o Stephen Z. Frank, Esq.
P.O. Box 129
North Conway, NH 03860

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Unsuitable Trading

Misleading Documents Sent to Customers

Failure to Update Form U4

Former registered representative of member firm of registered securities association made unsuitable recommendations, sent misleading account summaries and information, and failed to update timely his Form U4 to disclose two settlement agreements. *Held*, association's findings of violations and sanctions imposed are *sustained*.

APPEARANCES:

Stephen Z. Frank, Esq., for Richard G. Cody.

Marc Menchel, *Alan Lawhead,* and *Michael J. Garawski*, for Financial Industry Regulatory Authority, Inc.

Appeal filed: June 9, 2010
Last brief received: October 27, 2010

I.

Richard G. Cody, formerly a registered representative associated with Leerink Swann & Co. ("Leerink" or the "Firm"), appeals from FINRA disciplinary action.[1] FINRA found that Cody recommended unsuitable trading in several customer accounts in violation of NASD Rules 2310 and 2110.[2] FINRA further found that Cody violated NASD Rule 2110 by sending customers misleading account summaries and information, and by failing to timely update his Uniform Application for Securities Industry Registration or Transfer Form ("Form U4") to disclose two settlement agreements. Based on these violations, FINRA suspended Cody from associating with any FINRA member firm for one year, fined him a total of $27,500, and assessed $8,711.25 in costs. We base our findings on an independent review of the record.

II.

Cody began working in the securities industry in 1996. After working for several other firms, he was associated with Leerink from December 2001 through May 2005. Beginning in May 2005, Cody was associated with GunnAllen Financial, Inc. ("GunnAllen"), which was then a broker-dealer and registered investment advisor.[3] The conduct at issue in this case began in 2003.

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[1] On July 26, 2007, the Commission approved a proposed rule change that NASD filed seeking to amend its Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. Following the consolidation, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Rel. No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008). FINRA's disciplinary action was instituted after the consolidation of NASD and NYSE, but the conduct at issue took place before the consolidated rules took effect. Accordingly, NASD conduct rules apply and references to FINRA herein include references to NASD.

[2] NASD Rule 2310, sometimes referred to as the "suitability rule," requires that, in recommending the purchase, sale, or exchange of any security to a customer, a member must have reasonable grounds for believing that the recommendation is suitable for that customer based on the facts, if any, disclosed by the customer as to his other securities holdings and the customer's financial situation and needs. NASD Rule 2110 requires that members and associated persons "observe high standards of commercial honor and just and equitable principles of trade."

[3] According to the Central Registration Depository available on FINRA's website, Cody continued to be associated with GunnAllen through March 2010, and was registered with another member firm as of April 21, 2011.

A. The Customers

The conduct at issue in this case involves four of Cody's customers: Richard and Lenore DeSimone and James and Emma Bates (collectively, the "Customers").

1. Lenore and Richard DeSimone

The DeSimones began opening accounts with Cody in 1998, and transferred their accounts to Leerink when Cody moved there in December 2001. This case focuses on two of the DeSimones' Leerink accounts that together held well over half of the couple's assets: a joint account and Ms. DeSimone's individual retirement account ("IRA"), which included assets rolled over from another retirement account.

On the Leerink account opening forms, the DeSimones could choose from three options to describe their investment objectives: income, long-term growth, and short-term trading. The forms also listed four risk exposure options: low, moderate, speculation, and high risk. Ms. DeSimone's IRA form listed an objective of "long-term growth" and risk tolerance of "moderate," and at the hearing she described her risk tolerance as low to moderate. The joint account form listed an investment objective of "long-term growth" and risk exposure of "speculation." Ms. DeSimone testified that she had not "read the whole [document] through" before signing, and could not explain why the form listed a risk tolerance of speculation.[4] At the hearing, Cody admitted that the DeSimones were not interested in speculation as an "overall plan" or in Ms. DeSimone's account.

In February 2003, when the conduct at issue in this case began, Richard DeSimone was a 59 year old field engineer earning approximately $40-50,000 annually, and anticipating retirement from full-time employment. His wife, Lenore DeSimone, was 56 years old and had retired from a full-time position as an operations and purchasing manager in 2002. As part of her retirement package, Ms. DeSimone was receiving two years of payments totaling approximately $96,000 annually until August 2004. Before accepting this retirement package, the DeSimones explained to Cody that they would be relying on their retirement savings to cover their living expenses after the payments ended and asked for Cody's guidance in planning their investments in light of this goal.

The DeSimones had limited investment experience outside of their accounts with Cody. Ms. DeSimone had invested through a 401(k) account for approximately twenty years, and invested through an account with another broker-dealer for about six months. The DeSimones had also held savings and credit union accounts, savings bonds, and a small joint account with another broker-dealer.

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[4] When asked why the joint account form indicated an investment objective of speculation, Ms. DeSimone testified "I can't tell you why. Because I remember filling out forms, but the rest of it, I think Rich [Cody] filled out for us."

The DeSimones expressed an interest in bonds to Cody because they believed that bonds would help them meet their retirement income needs. Ms. DeSimone testified that they wanted "something . . . relatively safe, triple A, double A that type of bond," and requested bonds with maturity dates "somewhere around 10 years or so." Neither Ms. nor Mr. DeSimone had a sophisticated understanding of bond investing. For instance, they did not know that factors other than the stated coupon could affect the market value of bonds or that bond market values fluctuated. The DeSimones told Cody that they were "pretty naive about this whole market thing," were especially inexperienced in the bond market, and were relying on Cody to "watch our backs and make sure [our investments were] in our best interest."

Cody understood that the DeSimones were counting on their investment accounts to "generat[e] cash flow for living expenses," and that Ms. DeSimone's IRA "was earmarked . . . to draw off of" in retirement. He testified that "the number one priority" in the DeSimones' accounts "was to generate income and if it gr[e]w that much better." Cody knew that the DeSimones sought a fixed rate of return, and recommended a corporate bond investment strategy "because [corporate bonds] had highest yield."

2. James and Emma Bates

The DeSimones introduced their friends, James and Emma Bates, to Cody in January 2003. At the time, Mr. Bates was 69 years old and retired from his job in research and development, and Ms. Bates was 63 years old and retired from full-time work as a supervisor in an accounting department. Mr. Bates' prior investment experience included certificates of deposit, a joint account invested in individual stocks, bonds and REITs, and a former employer's 401(k) that included a choice of four funds. Mr. Bates did not have a sophisticated understanding of bond markets or investing strategies, and testified, "I don't know one bond from the other."

Mr. Bates opened an IRA at Leerink with an initial rollover contribution of $380,046, and hoped to generate $2,000 in monthly income from his account. The couple eventually deposited all of their savings in Leerink accounts with Cody, including in two IRAs for Ms. Bates. In Mr. Bates' account opening forms, he reported an investment objective of "income" and "low" tolerance for risk exposure. Consistent with these forms, Mr. Bates testified that he wanted to "maintain value" in the account but did not "expect it to grow as one would with a higher risk investment." Both Mr. and Ms. Bates discussed Mr. Bates' IRA with Cody, and Ms. Bates testified that the account "was our retirement, we needed to make sure it was safe." Cody understood Mr. Bates' retirement income goals for the account, and told Mr. Bates that "it would be no problem" to generate $2,000 in monthly income through bond investments. Cody understood that Mr. Bates "was drawing off his account right away" to cover living expenses, and did not want to deplete principal in his account.

B. Cody Recommends Credit Suisse Securities

On February 6, 2003, less than a week after Mr. Bates opened his account, Cody invested $86,500, or approximately 23% of Mr. Bates' initial contribution, in Credit Suisse First Boston Mortgage Securities Corp. IndyMac Manufactured Housing Passthru (CUSIP 22540ABH0) (the "Credit Suisse Securities"). Weeks later, on February 25 and February 27, Cody made several purchases of the Credit Suisse Securities for the DeSimones' joint account, investing $31,725 (approximately 13%) of the account's $242,784 market value.

Originally issued in 1997 with a stated maturity of February 2028, the Credit Suisse Securities were collateralized by "[f]ixed rate manufactured housing installment sales contracts and installment loan agreements." The securities were divided into eleven classes, or tranches. The tranche that Cody recommended was eighth in order of priority, a $11.9 million mezzanine tranche with a 7.105% coupon, which was subordinated to approximately $117.8 million in the senior tranches.

Cody learned about the Credit Suisse Securities from Timothy Skelly, then a principal at Leerink. Skelly told Cody the issuer, the coupon, and the stated date of maturity. According to Cody's testimony, Skelly described the Credit Suisse Securities as "asset-backed securit[ies] supported by mortgages on homes." Cody testified:

> In a perfect situation, the way I understood it is that [customers] would get their coupon, and then they would also receive payments back that was essentially part of the principal that they invested. What [Skelly] told us with this particular bond and this type of security . . . more often than not, the prepayment happens long before the actual maturity date. And he told us on this particular investment, he believed the life of the bond to be six to seven years. Seven percent coupon, six to seven year life, trading at a discount, A rated.

He also indicated that Skelly provided "essentially the printout off of Bloomberg, essentially all the description said was the coupon, maturity date, rating of the security, and just . . . saying that IndyMac Bank was the bank that handled the finances."

Cody testified that he recommended the Credit Suisse Securities to his Customers within a day of this discussion with Skelly and without getting any further information. He testified that he relied on Skelly's recommendation, which he thought "[s]eemed like a pretty good idea" based on the coupon, expected maturity, trading price, and A rating.

From the dates of these purchases through early 2004, the Credit Suisse Securities were repeatedly downgraded, with the Fitch rating falling from A to CCC. The asking price also sharply declined from around $104 in February 2003 to around $41 by mid-February 2004. In February 2004, Cody began selling the Customers' holdings. Cody sold the DeSimones' holdings in February and April 2004, realizing a loss of $17,377, or about 55% of their initial investment.

He sold Mr. Bates' holdings in February, April, and May 2004, realizing a loss of $56,868, or about 66% of Mr. Bates' initial investment. Cody did not consult with either the Bateses or the DeSimones before he began executing these sales.

At the hearing, Cody admitted that he did not really understand the Credit Suisse Securities when he recommended the Customers' purchases. He conceded that he did not know or explain to the Customers which tranche he was recommending, what kind of assets collateralized the securities, or other factors that would affect the risks of his recommendation. Although Cody testified that he relied on the rating, he did not know that the securities had been downgraded by Fitch four months before his recommendations. He testified that he was not concerned about the securities' liquidity at the time, but did not know where they were traded or whether they were traded by "end accounts or . . . institutions." He admitted that he did not understand the Credit Suisse Securities when he sold them to the Customers. He testified: "At the time I sold it to them I didn't really look at [the Credit Suisse Securities] to be significantly different than any other type of bond; obviously I've learned quite a bit since then . . . "

C. Cody Recommends Ahold, Calpine, and Royal Caribbean Bonds for Mr. Bates

Later in 2003, Cody purchased three non-investment grade securities for Mr. Bates' account. In May 2003, he purchased Ahold Financial USA Inc. ("Ahold") bonds for approximately $46,923. The next month, he purchased Calpine Corp. ("Calpine") bonds for approximately $38,532, and Royal Caribbean Cruises, Ltd. ("Royal Caribbean") bonds for approximately $26,051. When purchased, the Ahold and Calpine bonds were rated "highly speculative" (B1) and the Royal Caribbean bonds were rated "speculative" (Ba2) by Moody's. By June 30, 2003, these three non-investment grade bonds accounted for $108,575, or approximately 23%, of the market value reflected on Mr. Bates' Leerink statement. Cody sold the Calpine bonds in July 2003, the Ahold bonds in September 2003, and the Royal Caribbean bonds in November 2003, realizing a total gain of approximately $2,077.

D. Frequent Trading

1. Trading in Mr. Bates' Account

From February 2003 through May 2004, Cody effected 108 trades in Mr. Bates' account. Although Leerink statements reported that Mr. Bates' account had a market value of less than $475,000 during each month of this period, Cody made sixty-nine purchases totaling approximately $1.7 million. Cody often funded these purchases by selling other securities from the account. None of the securities in Mr. Bates' account was held for the entire sixteen-month period, and most of the securities sold had been held for fewer than three months. In addition, he often made purchases and sales of the same or similar securities in quick succession.

For instance, Cody purchased $25,000 par value of Teco Energy Inc. ("Teco") 6.125% notes on March 19, 2003, and $75,000 par Teco 7.2% notes on April 1, 2003. On April 7, 2003, he both sold the 6.125% notes and purchased $25,000 par Teco 7.0% notes. On April 11, he sold

the 7.2% notes. On April 24, he purchased $30,000 par 7.0% Teco notes. He sold $25,000 par 7.0% notes on May 6, 2003 and purchased $25,000 par 7.0% Teco notes on June 18. He sold the remaining 7.0% notes on July 24 and October 28.

According to the exhibits from the FINRA investigation, the purchases and sales in Mr. Bates' account during this period generated total commissions of more than $41,000, more than $17,000 of which went to Cody. The level of trading declined around May 2004, after Ms. Bates began pressing Cody to explain the account activity and values.

2. Trading in Ms. DeSimone's Account

From June 2003 through May 2004, Cody effected 140 trades in Ms. DeSimone's IRA. He made eighty-four purchases totaling more than $1.3 million during this period although the average market value reported for Ms. DeSimone's account on the Leerink statements was approximately $421,000. Cody generally sold other investments from the same account to fund these purchases. Only three fixed-income holdings were held for the entire period; these holdings had a total market value of $48,130 as of May 31, 2004, representing 11.7% of the $412,929 market value reflected on the corresponding Leerink statement. Many of the trades involved frequent purchases and sales of the same or similar securities in quick succession.

For example, on February 27, 2004 Cody purchased $25,000 par value Bally Total Fitness Holding ("Bally") 10.5% notes, and on March 5, he purchased another $25,000 par of the same notes. He sold these Bally notes on March 17 and March 18, 2004. On March 2, 2004, he purchased $15,000 par value of Merrill Lynch & Co. ("Merrill") medium-term zero-coupon notes. In two trades on March 8, he purchased another $45,000 par Merrill notes, and sold $20,000 par medium-term zero-coupon notes issued by another Merrill entity, Merrill Lynch & Co. Inc. ("Merrill Inc."). Eleven days later, on March 19, Cody purchased another $100,000 par of the Merrill medium-term zero-coupon notes.

According to exhibits from the FINRA investigation, the trades in Ms. DeSimone's account during this one-year period generated more than $36,000 in total commissions, more than $14,000 of which went to Cody. The FINRA examiner conducting the investigation calculated a commission to equity ratio of 8.7%, and a turnover ratio of 3.4.[5]

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[5] The 8.7% commission to equity ratio meant that Cody's recommendations would have had to generate 8.7% in gain to cover commissions and break even before generating any income for Ms. DeSimone. The turnover ratio of 3.4 reflected that the investments were replaced on average more than three times during the twelve-month period. FINRA declined to make findings regarding the performance of the accounts. *See also* infra the discussion of our *de novo* review of the evidence underlying these calculations in the text preceding note 43.

3. Control of Trading in Mr. Bates' and Ms. DeSimone's IRAs

The Customers had not signed documents giving Cody formal discretionary authority, but they allowed Cody to initiate and execute trades in their accounts before consulting them. Although Cody met with the Customers approximately six times a year and spoke with them several times a month, their discussions about individual trades almost always occurred after Cody executed them. Ms. DeSimone testified that the DeSimones orally agreed to allow Cody to make investments in their accounts before speaking with them.

The Customers testified that they trusted and relied on Cody to make appropriate investments. The DeSimones told Cody that they "were novices especially with the bond market," and Cody "assured [them] that he was looking out for [their] best interest." Ms. DeSimone testified that "95% of the time" Cody did not speak with her before making trades in her account, and that when she learned about the trades she thought they were "a done deal." Mr. Bates testified that he did not suggest investment ideas for his IRA, but rather wanted Cody to choose the investments. He did not recall Cody ever discussing trades with him before executing them. Mr. Bates learned about trades from confirmations, and Ms. DeSimone learned from spreadsheets that Cody prepared.

Cody testified at the hearing that he did not routinely discuss individual trades with the Customers in advance. He admitted that both Customers "relied upon and routinely followed his investment recommendations and deferred to his investment recommendations in almost all instances." When pressed to describe his discussions with the Customers, he admitted that their discussions were "not always specific to the particular bond that was bought or sold."

When the Customers asked Cody questions about the activity in their accounts, Cody offered reassurances and the Customers trusted these responses. For instance, in summer 2003, Mr. Bates asked Cody about the declining value of the Credit Suisse Securities on his statements and accepted Cody's assurance that the value reflected "an average of the bonds of Credit Suisse," but "not his particular bond." When Ms. DeSimone received a letter from Leerink asking for confirmation that she "underst[ood] the risks and benefits associated with investing in Collateralized Mortgage Obligations" in November 2003, she contacted Cody. He assured her that the letter was "just a formality from the front office. Don't worry about it. Everything is safe." Ms. DeSimone also asked Cody about the trading volume in her account in late 2003 or early 2004, but accepted his reply: "Don't worry about it. It is going to work out." When the Customers learned that they incurred significant losses upon the sales of the Credit Suisse Securities from their accounts in 2004, Cody assured them that the losses would be reimbursed.

E. Account Spreadsheets and Activity Sheets

From 2003 until his departure from Leerink in May 2005, Cody created and sent twenty-four spreadsheets to the DeSimones and twenty-two spreadsheets to Mr. Bates. Cody testified that he used the Leerink statements to compile the spreadsheets. He told the Customers that these summaries, which he referred to as ladders or bond ladders, were meant to simplify the review of their accounts.

Cody's initial spreadsheets described the Customers' bond holdings, listing issuers, coupon rates, maturity dates, and coupon payments. For each bond, the spreadsheets listed a dollar amount as the "quantity" held, but did not define quantity; the quantity was the par value, not the market value, of each bond. The sheets included a total figure based on the sum of the listed bonds' par values.

In September 2003, Cody began supplementing the DeSimones' spreadsheets with information about their other holdings, including stocks, mutual funds, and cash. The information for these other investments included market values, but Cody continued to use the bond holdings' par values without stating that he was doing so. These spreadsheets listed a "Total Portfolio" value that added the cash and market values for the other investments to the par values for the bonds. The Total Portfolio amounts on spreadsheets between September 2003 and July 2004 exceeded the market values of the accounts on the Leerink statements by approximately 24% to 46%. In July 2004, Cody began disclosing the bonds' market values.

In November 2003, Cody began including on the spreadsheets for Mr. Bates his Leerink cash holdings and a total amount that added the cash amounts to the bond par values. He continued to do this until November 2004 when he started including market values for the bonds. The total account values listed on the spreadsheets between November 2003 and September 2004 exceeded the market values listed on the Leerink statements by approximately 8.7% to 36%.

Cody did not disclose that he was using par values for the bonds and did not explain the distinction between par values and market values to his Customers. Ms. DeSimone testified that she believed that the spreadsheets reflected the value of their "total liquid assets." When she had asked Cody about dollar amount discrepancies between the spreadsheets and the Leerink statements, he attributed those differences to the calculation dates and fluctuations in the market rather than the difference between par values and market values. He advised the DeSimones to "ignore the statements from Leerink." Mr. Bates also thought the spreadsheets Cody sent prior to September 2004 reflected the value of each bond and the total value of the account. He did not understand at the time he received those spreadsheets that they did not reflect market values.

Cody acknowledged during the hearing that, by adding together cash values, market values and par values, he created total amounts that were "neither a market value nor a maturity value," and that these amounts "do[n]'t mean anything when you're just looking at the thing as we are looking at it right now." He claimed that the Customers "understood [the amounts] not to be a market value or what they're totally worth . . . because the way the spreadsheets started in origin, which was specifically just the bond quantities. . . ."

Cody sent other inaccurate information to the Bateses. He sent Ms. Bates five different spreadsheets between March and August 2004, each indicating that her IRA held a "Merrill Lynch/6.5% bond" that was not then in her account. In May 2004, Cody sent Mr. and Ms. Bates "account activity sheets" which indicated that Electronic Data Systems ("EDS") bonds that he sold from their accounts had been called when, in fact, they had not been called.

F. Cody's Form U4

After Cody left Leerink in May 2005, the DeSimones and the Bates spoke with Leerink managers about their accounts. The Customers raised concerns about Cody's recommendation of the Credit Suisse Securities, claimed that Cody had managed their accounts to maximize commissions, and alleged that the spreadsheets were misleading. Cody entered into settlement agreements with the Customers in August and September 2005, agreeing to pay $20,000 to the DeSimones and $56,000 to the Bateses. Although Cody was associated with GunnAllen at that time, he did not amend his Form U4 to reflect the settlements until September 2007.

G. Procedural History

On January 14, 2008, the FINRA Department of Enforcement (the "Department") filed a complaint (the "Complaint") charging, among other things, that Cody engaged in unsuitable and excessive trading in the Bateses' and DeSimones' accounts, sent false or misleading statements to the Customers without prior approval from Leerink management, and failed to update his Form U4 to disclose his settlements with the Customers. The FINRA Hearing Panel (the "Hearing Panel") unanimously declined Cody's pre-hearing request to introduce expert testimony, finding that such testimony would not be "necessary or helpful to the Panel in resolving the issues in this proceeding." During his cross-examination of the FINRA examiner, Cody challenged the examiner's calculations and other exhibits submitted by the Department. The Hearing Panel declined to admit the Department's calculation of turnover rate and commission to equity ratio for Mr. Bates' account, but admitted turnover and commission to equity calculations for Ms. DeSimone's account and, for both accounts, admitted Leerink statements and schedules of trades and compensation.

After a five-day hearing, the Hearing Panel found that Cody violated the suitability rule by: (i) recommending the Credit Suisse Securities for Mr. Bates' IRA and the DeSimones' joint account; (ii) recommending non-investment grade bonds for Mr. Bates' IRA, and (iii) recommending and effecting quantitatively unsuitable (*i.e.*, excessive) trading in Mr. Bates' and Ms. DeSimone's IRAs. The Hearing Panel also found that Cody failed to observe high standards of commercial honor and just and equitable principles of trade by sending spreadsheets that included "misleading 'total portfolio' values," by failing to submit the spreadsheets for supervisory approval, and by failing to amend timely his Form U4 to disclose the settlements. The Hearing Panel, after hearing Mr. Bates, Ms. Bates, Ms. DeSimone and Cody testify, found the Customers to be "generally highly credible witnesses." It found that Cody's explanations for his actions were generally not credible. The Hearing Panel suspended Cody for three months, fined him a total of $27,500, and assessed costs.

On cross-appeals, the National Adjudicatory Council ("NAC") affirmed the Hearing Panel's findings regarding the unsuitability of Cody's trading recommendations and Cody's failure to timely update his Form U4 on May 10, 2010. The NAC reversed the Hearing Panel's finding that Cody failed to obtain prior supervisory approval for the correspondence he sent to the Customers, but affirmed its findings that the spreadsheets and activity sheets were materially misleading and were inconsistent with just and equitable principles of trade. Finding that "a

stronger sanction is needed to remedy" Cody's violations of the suitability rule, the NAC increased the suspension to one year, while sustaining each of the fines imposed by the Hearing Panel. This appeal followed.

III.

Exchange Act Section 19(e) provides that, in reviewing a disciplinary proceeding by a self-regulatory organization ("SRO"), we shall determine whether the associated person engaged in the conduct found by the SRO, whether the conduct violated the SRO rules at issue, and whether those rules were applied in a manner consistent with the purposes of the Exchange Act.[6] In conducting our *de novo* review, we apply a preponderance of the evidence standard to determine whether the record supports FINRA's findings that Cody's conduct violated its rules.[7]

A. Suitability of Cody's Recommendations

Under NASD Rule 2310, a registered representative may recommend a purchase or sale of a security only if he or she "ha[s] reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs." Recommendations violate the rule if: (i) the representative's understanding of the investment is insufficient to establish a reasonable basis for making a recommendation; (ii) the representative inadequately assesses whether the recommendation is suitable for the "specific investor to whom the recommendation is directed;"[8] or (iii) the level of trading recommended by the representative is excessive in light of the customer's investment needs and objectives.[9] A violation of Rule 2310 constitutes a violation of Rule 2110, which requires registered representatives to "observe high standards of commercial honor and just and equitable principles of trade."[10]

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[6] 15 U.S.C. § 78s(e).

[7] *See Seaton v. SEC*, 670 F.2d 309, 311 (D.C. Cir. 1982) (upholding preponderance of evidence standard in NASD disciplinary proceeding).

[8] *F.J. Kaufman & Co. of Va.*, 50 S.E.C. 164, 168-69 (1989).

[9] NASD Interpretive Material 2310-2(b)(2).

[10] *Perpetual Sec., Inc.*, Exchange Act Rel. No. 56613 (Oct. 4, 2007), 91 SEC Docket 2489, 2504 n.50; *see also Thomas W. Heath, III*, Exchange Act Rel. No. 59223 (Jan. 9, 2009), 94 SEC Docket 13242, 13247 n.8 ("It is well-established that a violation of another self-regulatory organization . . . or Commission rule or regulation will also automatically constitute a violation of the" NYSE rule regarding just and equitable principles of trade), *aff'd*, 586 F.3d 122 (2d Cir. 2009).

1. Credit Suisse Securities

A representative's recommendation carries the implicit representation that it was "responsibly made on the basis of actual knowledge and careful consideration."[11] Accordingly, the suitability rule requires that a representative ensure that he or she has an "adequate and reasonable" understanding of an investment before recommending it to customers.[12] This understanding must include the "potential risks and rewards"[13] and potential consequences of such recommendation.[14]

Cody did not have an adequate and reasonable basis for recommending the Credit Suisse Securities. By his own admission, Cody did not understand their features and "didn't really look at [them] to be significantly different than any other bond." He recommended them a short time after a limited discussion focused on yield, maturity date, and rating, and failed to evaluate other factors that could affect their value. For example, Cody failed to learn which tranche he was recommending or the associated subordination risks, details about the assets collateralizing the securities, or other factors that would affect the risks and liquidity of the securities he recommended. Although he testified that he relied on the credit rating, he did not inquire as to the ratings history, which included a recent downgrade. Cody's failure to gain an understanding of essential features of the Credit Suisse Securities rendered his recommendations unsuitable.

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[11] *Kaufman*, 50 S.E.C at 168 n.18 (citing *Alexander Reid & Co., Inc.*, 40 S.E.C. 986, 990-91 (1962) ("A broker-dealer in his dealings with customers impliedly represents that his opinions and predictions respecting a [security] which he has undertaken to recommend are responsibly made on the basis of actual knowledge and careful consideration . . . . [I]t is not a sufficient excuse that a dealer personally believes the representation for which he has no adequate basis."); *Distribution by Broker-Dealers of Unregistered Securities*, Exchange Act Rel. No. 6721 (Feb. 2, 1962) ("[T]he making of recommendations for the purchase of a security implies that the dealer has a reasonable basis for such recommendations which, in turn, requires that, as a prerequisite, he shall have made a reasonable investigation.")).

[12] *Hanley v. SEC*, 415 F.2d 589, 597 (2d Cir. 1969).

[13] *Michael Frederick Siegel*, Exchange Act Rel. No. 58737 (Oct. 6, 2008), 94 SEC Docket 10501, 10513 (quoting *F.J. Kaufman & Co.*, 50 S.E.C. at 168 & n.18) (finding reasonable basis violation when representative did not read offering documents and, in any case, the documents included "conflicting or confusing information"), *petition denied in part and remanded in part*, 592 F.3d 147 (D.C. Cir. 2010). We reject Cody's argument that *Siegel* may be distinguished as a selling away case in which the representative's transactions were not monitored by his firm. Regardless of whether a firm monitors transactions by its representatives, the representatives are responsible for the suitability of the recommendations they make to their customers. *See infra* notes 19-20.

[14] *Siegel*, 94 SEC Docket at 10513.

Cody claims that Commission precedent holds that his recommendation could not have been unsuitable unless there was something "unusual or special about [the Credit Suisse Securities] rendering [them] unsuitable for all retail investors."[15] Contrary to Cody's claim, we have held that a broker-dealer must have a reasonable and adequate basis for any recommendation he makes. This requirement, which we have referred to as the "reasonable basis test," is subsumed within the suitability rule because "a broker cannot determine whether a recommendation is suitable for a specific customer unless the broker understands the risks and rewards inherent in that recommendation."[16] Thus, a broker violates the suitability rule when he fails to conduct a reasonable investigation.

Cody asserts that both he and the DeSimones had prior experience with asset-backed securities (ABSs), and suggests that this experience was relevant to the suitability requirement. However, even assuming this to be true, Cody's or the DeSimones' experience with other ABSs in general does not establish a reasonable basis for Cody's recommendation of the Credit Suisse Securities.[17] Moreover, because Cody admits that he "didn't really look at [the Credit Suisse

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[15] Citing *Terry Wayne White*, 50 S.E.C. 211, 213 (1990) (explaining that "[a] broker cannot conclude that a recommendation is suitable for a *particular* customer unless he has a reasonable basis for believing that the recommendation could be suitable for at least *some* customers" (emphasis in original)); and *Kaufman*, 50 S.E.C. at 169 (stating that "a broker may violate the suitability rule if he fails so fundamentally to comprehend the consequences of his recommendation that such recommendation is unsuitable for any investor . . . "). These cases stand for the "well established" proposition that a "broker cannot recommend any security to a customer 'unless there is an adequate and reasonable basis for such recommendation,'" *White*, 50 S.E.C. at 212 (citing *Hanley*, 415 F.2d at 597) -- not Cody's claim that the suitability of a security for some customers excuses a representative's failure to establish an adequate and reasonable basis for a recommendation.

[16] *F.J. Kaufman & Co.*, 50 S.E.C. at 168 (explaining that reasonable basis "relates only to the particular *recommendation*, rather than to any particular *customer*" (emphasis in original); *see also id*. at 171 (explaining that the suitability rule imposes on a representative separate obligations to "know his security," "know his customer," and "know his transaction," including its implications and consequences for customers); *C. Gilman Johnston*, 42 S.E.C. 217, 219 (1964) (stating that the "reasonable grounds" suitability requirement "presupposes that a person recommending securities will be able to make such a determination. Otherwise, member firms could avoid the standard of conduct imposed by the rule by not training their salesmen"); NASD Notice to Members 01-23, Suitability Rule and Online Communications, 5 n.4 (describing customer-specific, reasonable basis, and excessive trading as separate types of suitability violations).

[17] *Larry Ira Klein*, 52 S.E.C. 1030, 1037 n.28 (1996) (rejecting claim that prior investments demonstrate suitability of a broker's later recommendations (citing *Douglas Jerome Hellie*, 50 S.E.C. 611, 613 (1991)); *Hanley*, 415 F.2d at 596 ("The fact that [the broker's]

Securities] to be significantly different than any other bond," his prior experience with ABSs did not factor into this recommendation.

Cody argues that he was entitled to rely on the information he obtained from Skelly about the security without conducting any further inquiry.[18] Skelly's familiarity with the Credit Suisse Securities, however, does not excuse Cody's violation; Cody, as the broker who recommended the securities, had an independent obligation to ensure that he understood them.[19] Even accepting Cody's testimony that he thought the Credit Suisse Securities "seemed like [they] fit what the client needed," a representative must have a reasonable understanding of the risks and benefits of the investment before he can recommend it.[20] Cody did not have such a reasonable understanding. Therefore, we find that his recommendation violated the suitability requirements under Rule 2310 and that, in turn, he engaged in conduct inconsistent with just and equitable principles of trade under Rule 2110.

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customers may be sophisticated and knowledgeable does not warrant a less stringent [investigation] standard.").

[18] Cody argued before FINRA that he "took it upon himself to discuss the DeSimones and Bateses with Mr. Skelly and asked him to make the suitability determination." Neither his own testimony nor any other record evidence, however, supports this claim, and Cody also conceded before FINRA that "in the end suitability is his responsibility . . . ."

[19] *See Dan King Brainard*, 47 S.E.C. 991, 996-97 (1983) (finding that "statements made by a salesman's superiors [are not] an adequate basis for representations made to investors"); *J. Stephen Stout*, 54 S.E.C. 888, 911-12 & n.53 (2000) (stating that a broker "cannot excuse his failure to conduct [a suitability] inquiry by claiming that he blindly relied on his firm's recommendations"); *Stephen Thorlief Rangen*, 52 S.E.C. 1304, 1309 (1997) ("Rangen cannot shift his responsibility as an investment counselor to his employer."); *Thomas Arthur Stewart*, 20 S.E.C. 196, 207 (1945) ("[A broker's] ignorance of his business would not excuse . . . an association member who undertakes to make recommendations with respect to securities transactions."); *cf. SEC v. Hansho*, 784 F. Supp. 1059, 1108 (S.D.N.Y. 1992) (noting that representatives "hold themselves out as professionals with specialized knowledge and skill to furnish guidance" and that "[y]outh or inexperience does not excuse a registered representative's duty to his clients" (citations omitted)).

[20] *See Hanley*, 415 F.2d at 596 (stating that "a salesman cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant. He must analyze sales literature and must not blindly accept recommendations made therein."); *see also Joseph Abbondante*, 58 S.E.C. 1082, 1106 n.62 (2006) (stating that "an honest belief in an issuer's prospects . . . does not in itself give one a reasonable basis for recommending the investment to others"); *Alexander Reid & Co.*, 40 S.E.C. at 990-91 (stating that "it is not a sufficient excuse that a dealer personally believes the representation for which he has no adequate basis").

2. Non-Investment Grade Securities

In addition to having a reasonable basis for making a recommendation, a registered representative's "recommendations must be consistent with his customer's best interests"[21] and be "tailor[ed] . . . to the customer's financial profile and investment objectives."[22] Generally, "risky investments are unsuitable recommendations for investors with relatively modest wealth and limited investment experience."[23] A broker recommending speculative investments also has "a duty to satisfy himself . . . that the customer understands and is willing to undertake the risks."[24]

We find that Cody's recommendations of the Ahold, Calpine, and Royal Carribean bonds were unsuitable and inconsistent with just and equitable principles of trade. Cody recommended that Mr. Bates make substantial investments in these bonds, which were rated speculative and highly speculative, even though he knew that Mr. Bates was retired, needed to preserve principle, requested low-risk investments, and needed immediate income for monthly withdrawals to cover living expenses. Cody's recommendations were inconsistent with Mr. Bates' financial profile and conservative investment objectives. Contrary to Cody's claim, the recommendations did not become suitable because he "monitored the investments carefully and sold the[m] when profitable." Suitability is determined at the time the recommendation is made; unsuitable recommendations do not become suitable if they later result in a profit.[25]

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[21] *Scott Epstein*, Exchange Act Rel. No. 59328 (Jan. 30, 2009), 95 SEC Docket 13833, 13851 n.24, *appeal filed*, No. 09-1550 (3d Cir. 2009); *Raghavan Sathianathan*, Exchange Act Rel. No. 54722 (Nov. 8, 2006), 89 SEC Docket 774, 782, *petition denied*, 304 F. App'x 883 (D.C. Cir. 2008) (unpublished); *Wendell D. Belden*, 56 S.E.C. 496, 503 (2003); *Daniel Richard Howard*, 55 S.E.C. 1096, 1100 (2002), *aff'd*, 77 F. App'x 2 (1st Cir. 2003) (unpublished).

[22] *F.J. Kaufman & Co.*, 50 S.E.C. at 168.

[23] *Luis Miguel Cespedes*, Exchange Act Rel. No. 59404 (Feb. 13, 2009), 95 SEC Docket 14272, 14281, *remanded on other grounds*, No. 09-1096 (D.C. Cir. 2009).

[24] *Donald T. Sheldon*, 51 S.E.C. 59, 74 n.59 (1992); *see also Henry James Faragalli*, 52 S.E.C. 1132, 1141 (1996); *Ward*, 56 S.E.C. at 259 (finding that broker improperly recommended a collateralized mortgage obligation investment "without also disclosing the associated risks"); NASD Notice to Members 96-21 ("Members are cautioned to take special care with respect to their suitability analyses where the securities involved are low-priced or speculative in nature.").

[25] *Klein*, 52 S.E.C. at 1037 n.29; *Laurie Jones Canady*, 54 S.E.C. 65, 81 (1999) ("The actual success or failure of [respondent's] purported trading strategy is irrelevant . . . . Unknown to her customers, [respondent's] 'trading strategy' generated high costs for her customers . . . and deviated grossly from these customers' stated conservative investment objectives."), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000); *Eugene J. Erdos*, 47 S.E.C. 985, 988 n.10 (1983), *aff'd*, 742 F.2d 507 (9th Cir. 1984); *cf. Janet Gurley Katz*, Exchange Act Rel. No. 61449 (Feb.1, 2010), 97 SEC Docket 25074, 25100 (finding that several of broker's

Cody attempts to justify his recommendations by arguing that Mr. Bates started withdrawing more than the $2,000 per month originally estimated. Cody contends that he needed to "be creative" to cover increased withdrawals and that investment grade bonds were not generating enough income to maintain principal. This argument fails for two reasons. First, the factual assertion is not supported by the record. Mr. Bates had not made a single withdrawal when Cody purchased the Ahold bonds in May 2003, and Cody purchased the Calpine and Royal Caribbean bonds the next month when Mr. Bates had made only one $2,500 withdrawal.

Second, an increase in withdrawals would not, without more, establish changed investment objectives or willingness to take on additional risk so as to render the recommendations suitable. Even if Mr. Bates were interested in pursuing higher returns through riskier investments, we have long held that a desire for yield does not justify recommendations that deviate from the customer's other investment objectives,[26] nor does it "relieve[] [the representative] from his duty to recommend only those trades suitable to" the customer's situation.[27] "[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."[28]

3. Excessive Trading

Excessive trading occurs when a registered representative has control over the trading in an account and the level of trading in that account is inconsistent with the customer's objectives and financial situation.[29] The requisite control may be established when the customer relies on the representative such that the representative controls the volume and frequency of

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"recommendations may have yielded some positive returns, but they still represented risky and costly investment choices given [the customers'] investment profiles"), *appeal filed*, No. 10-1068 (D.C. Cir. Mar. 26, 2010).

[26] *Klein*, 52 S.E.C. at 1037.

[27] *Rafael Pinchas*, 54 S.E.C. 331, 342 (1991); *see also Erdos*, 47 S.E.C. at 989; *Charles W. Eye*, 50 S.E.C. 655, 658 (1991) (finding that a customer's "request for a plan to increase . . . income was not a warrant to escalate risks unduly. If the only approach capable of producing the desired income involved significant dangers, [the broker] should have advised against it.").

[28] *Jack H. Stein*, 56 S.E.C. 108, 113 (2003).

[29] *Harry Gliksman*, 54 S.E.C. 471, 475 (1999), *aff'd*, 24 F. App'x 702 (9th Cir. 2001) (unpublished); *see also Rangen*, 52 S.E.C. at 1309 (finding that the representative violated the suitability rule by "us[ing] his influence over his customers' accounts to pursue an aggressive, short-term trading strategy that was inconsistent with his customers' investment objectives").

transactions.[30] A representative exercises *de facto* control if the customers "were not consulted, nor typically even made aware of, the particular trades executed in their account until well after the fact."[31]

The evidence establishes that Cody controlled the volume and frequency of trading in the Customer accounts. Both the Bateses and Ms. DeSimone testified that Cody routinely initiated and executed trades in their accounts before consulting or informing them and that they learned about these trades only after they had been completed. At the hearing Cody admitted that he did not tell the Customers about his intentions to buy or sell particular securities before, or even on the same day as, he made those trades.

A representative also exercises *de facto* control if the customer "relied heavily on and followed [the representative's] advice."[32] We have found *de facto* control when "consultations with [the customers] on investment choices were merely a formality"[33] because the customers did not have "sufficient understanding to make an independent evaluation of" the broker's recommendations.[34] Here, Cody maintained *de facto* control because the Customers did not

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[30] *Clyde J. Bruff*, 53 S.E.C. 880, 883 (1993); *Rangen*, 52 S.E.C. at 1309; *John M. Reynolds*, 50 S.E.C. 805, 807 (1991).

[31] *Frederick C. Heller*, 51 S.E.C. 275, 278 & n.7 (1993) (distinguishing cases involving pre-approval of recommendations); *see also Reynolds*, 50 S.E.C. at 807 (finding control where the broker did "not claim that [customers] suggested particular transactions on their own or approved particular transactions before their execution").

[32] *Rangen*, 52 S.E.C. at 1309-10; *see also Gerald E. Donnelly*, 52 S.E.C. 600, 604 (1996) (finding control when customers "approved individual transactions simply on the basis of [the broker's] recommendations"); *Joseph J. Barbato*, 53 S.E.C. 1259, 1277 & 1272 (1999) (finding *de facto* control when the broker initiated all trading, and the customer "placed his trust and confidence in [the representative] and allowed him to decide what to buy or sell in the account," and "habitually followed [the representative's] recommendations").

[33] *Michael David Sweeney*, 50 S.E.C. 761, 765-66 (1991) (finding control when customers "did not initiate the transactions in their accounts, nor did they fully understand the trading therein" and "were relying totally on the [brokers]"); *Bruff,* 53 S.E.C. at 883 (stating that "lack of sophistication with investing placed [customer] in a position where she had to rely on [the representative] for advice"); *Sandra K. Simpson*, 55 S.E.C. 766, 796 (2002) (finding *de facto* control established "either because the customer relied on her, or because the customer was incapable of controlling the account").

[34] *Erdos*, 47 S.E.C. at 990; *Al Rizek*, 54 S.E.C. 261, 270 (1999) (finding *de facto* control when customers were "lacking in the degree of investor sophistication necessary to understand [their broker's trading] strategy and [were] unable to make any sort of independent evaluation of that strategy"); *cf. Follansbee v. Davis*, 681 F.2d 673, 676-77 (9th Cir. 1982) ("[T]he account may be in the broker's control if his customer is unable to evaluate his

independently evaluate his recommendations but rather acquiesced in his trades. Cody admitted throughout these proceedings that the Customers trusted him to guide their investment strategies and routinely followed his recommendations. Mr. Bates testified that he did not suggest investment ideas but rather trusted Cody to direct the investments in his account. Ms. DeSimone testified that she trusted Cody to select investments before consulting her, and to "watch our backs and make sure [our investments were] in our best interest."

Cody makes three arguments that he lacked control over the accounts. First, he asserts that the Customers had relevant prior investment experience, suggesting that they were sufficiently sophisticated to control their own accounts. The evidence establishes that the Customers had little if any experience evaluating individual bonds or short-term bond trading, and relied heavily on Cody's recommendations. Mr. Bates testified, "I don't know one bond from the other." The DeSimones told Cody that they "were novices especially with the bond market" and responded to a recommendation by stating "we are pretty naive about this whole market thing" and evaluated his recommendation by asking "Would you trust your parents in these investments?" After Cody assured them that he "wouldn't steer [them] wrong," the DeSimones accepted the recommendation.[35]

Second, Cody argues that the Customers' review of confirmations and statements demonstrates their control, but we have rejected claims that the receipt of such post-trade notice amounts to control over accounts.[36] Third, he claims that the Customers' questions demonstrated

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recommendations and to exercise an independent judgment."); *Carras v. Burns*, 516 F.2d 251, 258-89 (4th Cir. 1975) (noting that "control may be inferred from the broker-customer relationship when the customer lacks the ability to manage the account and must take the broker's word for what is happening" and "[t]he issue is whether or not the customer, based on the information available to him and his ability to interpret it, can independently evaluate his broker's suggestions").

[35] The Hearing Panel found the Customers' testimony to be generally highly credible and Cody's testimony not credible. The credibility determination of an initial fact finder is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor. *See, e.g., Rita J. McConville*, 58 S.E.C. 596, 608 n.21 (2005), *petition denied*, 465 F.3d 780 (7th Cir. 2006). Such determinations generally "can be overcome only where the record contains substantial evidence for doing so." *Canady*, 54 S.E.C. at 78 (citing *Anthony Tricarico*, 51 S.E.C. 457, 460 (1993), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000)). We do not find that the record contains such evidence here.

[36] *See Sweeney*, 50 S.E.C. at 766 & n.17 (1991) (finding confirmations and monthly statements did not negate control because the customers were not "sufficiently knowledgeable to understand that the transactions in their accounts were excessive" when, for instance, customers did not know that the brokers made a commission on every trade or how the trading activity affected the value of their accounts); *Stein*, 56 S.E.C. at 119 n.31 (rejecting argument that customer was "estopped from objecting to his conduct because she was fully aware of his trading

active management of their accounts, but their reliance on his spreadsheets and their acceptance of vague and misleading responses to their questions confirms that they were, in fact, "unable to make any sort of independent evaluation of" Cody's trading in their accounts during the trading period.[37] Under these circumstances, we find that Cody exercised *de facto* control over Mr. Bates' and Ms. DeSimone's accounts.

Having established Cody's control, we next examine the level of trading in the accounts. Customer investment objectives and financial situation are the benchmarks for evaluating whether the level of trading in any account is appropriate.[38] Here, neither Mr. Bates nor Ms. DeSimone expressed interest in short-term or speculative trading in these accounts, which were to be used to fund retirement, demonstrating a need to protect principal and limit risk-taking. Yet Cody engaged in aggressive "in-and-out" trading, repeatedly purchasing bonds and then selling them after relatively short holding periods to purchase other securities.[39] Cody often effected multiple and overlapping trades in the same or similar securities within weeks, or even days, of one another. Such in-and-out trading is a "hallmark of excessive trading"[40] and "extremely difficult for a broker to justify."[41]

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activities" based on receipt of confirmations, periodic account statements and discussions of "trading philosophy and investment methods"); *cf. Karlen v. Friedman*, 688 F.2d 1193, 1200 (8th Cir. 1982) ("When a customer lacks the skill or experience to interpret confirmation slips, monthly statements or other such documents, courts have generally refused to find that they relieve a broker of liability for its misconduct."); *Katz*, 97 SEC Docket at 25103 ("[R]atification of a transaction after the fact does not establish that trades were authorized before being executed"); *William C. Piontek*, 57 S.E.C. 79, 92 (2003)(rejecting claim that "customers subsequently ratified . . . trades" in an unauthorized trading case and finding "after-the-fact acceptance of an unauthorized trade does not transform it into an authorized trade"); *Edgar B. Alacan*, 57 S.E.C. 715, 728 n.27 (2004) (finding that any delay in complaining about unauthorized trades "was a consequence of misplaced trust in [the representative], rather than approval of his actions").

[37] *Rizek*, 54 S.E.C. at 270.

[38] *Rangen*, 52 S.E.C. at 1309.

[39] "The term 'in and out' trading denotes the sale of all or part of a customer's portfolio, with the money reinvested in other securities, followed by the sale of the newly acquired securities." *Costello v. Oppenheimer & Co., Inc.,* 711 F.2d 1361, 1369 n.9 (7th Cir. 1983).

[40] *Howard*, 55 S.E.C. at 1100-01.

[41] *Pinchas,* 54 S.E.C. at 339 (*citing Costello*, 711 F.2d at 1369 n.9) (noting that in-and-out trading can, by itself, establish excessive trading).

Cody executed 108 trades over sixteen months in Mr. Bates' account, including sixty-nine purchases totaling approximately $1.7 million – more than three times the average market value of the account during this period. None of these securities was held for the entire period, and most of the sales involved securities held for fewer than three months. Although Ms. DeSimone's account had an average market value of less than $425,000, Cody executed 140 trades, including eighty-four purchases totaling more than $1.3 million, over the year at issue. Only three fixed-income securities were held for the entire period, representing 11.7% of the market value at the end of the twelve-month trading period, and investments were replaced on average more than three times during the period.

This aggressive short-term trading generated large commissions that were contrary to the Customers' interest in minimizing costs and preserving capital. Mr. Bates paid more than $41,000 in commissions during the same sixteen-month period he sought to earn approximately $32,000 in income. Ms. DeSimone paid more than $36,000 in commissions for twelve months of trading in her IRA. Her investments would have had to earn an 8.7% return just to cover these commissions and avoid net losses. Such a high break-even level suggests overly aggressive trading given Cody's understanding that Ms. DeSimone's "number one priority . . . . was to generate income" to cover living expenses during retirement.[42]

Cody argues that the finding of excessive trading was based on unreliable evidence. He asserts that the Hearing Panel's decision to exclude the FINRA examiner's turnover and commission-to-equity calculations for Mr. Bates' account (the "Bates Ratios") discredited all of the other calculations and trading evidence in the record. He also argues that the NAC improperly relied on such discredited evidence as the basis for its findings with respect to Ms. DeSimone's account.

The Hearing Panel excluded the Bates Ratios after Cody established that the calculations were based on a schedule that incorrectly transposed market values and purchase amounts from the monthly Leerink statements. Neither the Hearing Panel nor the NAC relied on either of these measures to determine whether there was excessive trading in Mr. Bates' account. The Hearing Panel considered the other objections Cody raised at the hearing, which focused on valuations on the Leerink statements and other purported inconsistencies between calculation schedules and the statements. Regarding the Leerink statements, the panel observed that, "while some of the valuations may appear questionable, Cody offered no evidence from other sources showing that the [Leerink statements] were incorrect." The Hearing Panel also "compar[ed] the schedules and the account statements" and found "that they appear consistent." The NAC similarly concluded that the FINRA examiner's calculations with respect to Ms. DeSimone's account "were reliable."

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[42] FINRA did not make findings regarding whether the "alleged excessive trading in [Mr. Bates' or Ms. DeSimone's] IRAs generated losses;" the market value reflected on the Leerink statements for Ms. DeSimone's IRA during the trading period fell from $460,563.17 to $412,928.94.

In this appeal, Cody has not offered additional evidence of calculation or valuation errors or further support for his suggestion that errors in the calculation of the Bates Ratios were sufficiently egregious to compel us to disregard all of the other evidence. In our independent review of the evidence, we found certain potential discrepancies in the admitted exhibits that could affect the FINRA calculations. When read most favorably to Cody, the discrepancies could, for instance, reduce the number of trades in Mr. Bates' account from 109 to 108, reduce the total purchases in Ms. DeSimone's account from $1.43 million to $1.35 million, and reduce the turnover ratio in Ms. DeSimone's account from 3.40 to 3.21. We find that these adjusted figures are nevertheless consistent with a finding of excessive trading in both accounts given the Customers' conservative investment objectives and financial situations.[43]

Moreover, even if we were to disregard the trading evidence submitted by FINRA, the record still supports a finding of excessive trading. As we recognized in *Gerald E. Donnelly*, our assessment of whether trading is excessive "does not rest on any 'magical per annum percentage,' however calculated."[44] Other evidence confirms that Cody engaged in excessive trading given that the Customers were not interested in short-term or speculative trading. Cody himself submitted exhibits that reflected trading activity in the Customer accounts generally consistent with the Leerink statements and the exhibits prepared by the FINRA examiner. His exhibits confirm his aggressive short-term trading in both accounts, including numbers of trades and purchases as cited in this opinion, and the pattern of in-and-out trading and short holding periods.[45]

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[43] *See Donnelly*, 52 S.E.C. at 602 n.11 (noting respondent's acknowledgment that "an annualized turnover rate of between two and four percent is presumptive of churning"); *Stein*, 56 S.E.C. at 118 (noting that "turnover rates between three and five have triggered liability for excess trading"); *Donald A. Roche*, 53 S.E.C. 17, 21 (1997) (finding account with turnover rate of 3.3 was excessively traded for conservative investor); *Simpson*, 55 S.E.C. at 794 (finding excessive trading in account of elderly retiree with conservative investment objectives and annualized turnover rate of 2.1); *Stout*, 54 S.E.C. at 894 n.18 (noting expert testimony that, as a "rule of thumb," "a turnover rate of two may be considered suggestive of excessive trading for a conservative investor").

[44] 52 S.E.C. at 603; *see also Stein*, 56 S.E.C. at 117-18 (noting that "there is no single test for making an excessive trading determination").

[45] Contrary to Cody's arguments before the NAC, the Hearing Panel did not shift the burden of proof to Cody, and he was not disciplined for his failure to "articulate the reasons for" his trading. After the Department submitted evidence of violative conduct, the Hearing Panel offered Cody repeated opportunities to "articulate a rationale for his trading, either on an overall or trade-by-trade basis," but found that he was "unable to offer any specific colorable explanation." FINRA considered Cody's testimony before determining that the preponderance of the evidence established that he recommended and effected frequent trades, including short term and in-and-out trading, inconsistent with the Customers' investment objectives and financial

Cody also argues that FINRA used an inappropriately abbreviated timeframe to find excessive trading. He asserts that there must be a "drastic change" in trading strategy in order to justify a review of a trading period "less than the life of the account."[46] However, an excessive trading inquiry does not require "looking only at the full period that the broker managed the customer's account; rather it is appropriate for us also to review the trading done over a reasonably abbreviated portion of the entire period."[47] Here, the excessive trading took place over the sixteen months after Mr. Bates first opened his account, and twelve months in the DeSimones' account. Moreover, the trading periods under review end in May 2004 – around when Ms. Bates questioned the level of activity and expressly asked Cody to stop trading.[48]

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situations. *See Pinchas*, 54 S.E.C. at 339 (finding excessive trading when "nothing in the record reveals any justification for" a pattern of in-and-out trading in a customer account).

[46] Cody cites *Frederick C. Heller*, which found excessive trading based on turnover analysis of a portion of the life of a customer account, indicating that the "four and one-half month review period was appropriate because it [was] the period during which [the representative] implemented [a] drastic change in trading strategy, with [an] increased volume of trading." 51 S.E.C. at 279. However, *Heller* did not hold that such a drastic change in strategy was a prerequisite to limiting the period considered. In any case, Cody argues that, as in *Heller*, the trading in the Customer accounts during the periods at issue was not representative of the overall trading in the account.

[47] *Stein*, 56 S.E.C. at 118 n.30 (citing *Peter C. Bucchieri*, 52 S.E.C. 800, 805 (1996)); *see also Simpson*, 55 S.E.C. at 795 n.45 ("That the broker . . . managed to obey the securities laws at one time does not insulate her from liability.").

Cody also argues that his trading in Mr. Bates and Ms. DeSimone's IRAs was suitable when considered with the Customers' spouse and joint accounts. For example, Cody argues that his trading levels in these accounts were appropriate as part of a "family" plan, and that the absence of excessive trading charges in other accounts precludes finding excessive trading in these accounts. The evidence and testimony confirm that these accounts were treated as separate accounts by both the Customers and Cody, however, and we will not conflate the accounts for purposes of the excessive trading inquiry. *See, e.g., Heller*, 51 S.E.C. at 279 (declining to measure the trading activity "against the total assets for which [the respondent] was the registered representative"); *Bucchieri*, 52 S.E.C. at 806 (stating that "the assets by which the rate of activity is to be measured are those in the account, not other assets that the customer may possess").

[48] Cody argues that Mr. Bates' and Ms. DeSimone's accounts were profitable, suggesting that the trades were therefore suitable. We are not persuaded by Cody's calculation of trading returns, which offset the Customers' trading losses with the amounts paid to the Customers in the settlements. *See, e.g., Michael T. Studer*, 57 S.E.C. 1011, 1019 n.22 (2004) (noting that NASD net loss computation regarding a churned account excluded settlement payment amounts), *aff'd*, 148 F. App'x 58 (2d Cir. 2005). As noted, suitability is determined at

Given the Customers' conservative investment objectives and financial situations, the control Cody exercised over the accounts, and the short-term nature of the trading, we find that Cody engaged in excessive trading in Mr. Bates' and Ms. DeSimone's accounts that violated the suitability rule and was inconsistent with just and equitable principles of trade.

B. Other Conduct Inconsistent with Just and Equitable Principles of Trade

1. Account Spreadsheets and Activity Sheets

Material misstatements and misleading statements to a customer are inconsistent with just and equitable principles of trade.[49] In particular, we have found that "inaccurate and misleading account summaries and/or reports" fail to satisfy these principles.[50]

Cody does not dispute that the account summaries that he sent to the DeSimones and Mr. Bates included calculations of total account and total portfolio values that were materially misleading. Cody failed to disclose that the values reported for the bond holdings were par values. The Customers thought that the stated amounts were market values. By adding cash and market values to par values, Cody created totals that he admitted "do[n]'t mean anything when you're just looking at the thing as we are looking at it right now." These totals were particularly problematic because they overstated the account values by approximately 24% to 46% for the DeSimones, and by approximately 8.7% to 36% for Mr. Bates.

In addition, the Bateses' account activity statements inaccurately indicated that their EDS securities holdings were called, and spreadsheets for Ms. Bates inaccurately stated that she held specific bonds.[51] These misstatements were material to the Customers' efforts to understand the trading and market values of their accounts, and are not justified by Cody's claim that he sent this information in response to Customer questions. By sending his Customers these documents containing material misstatements, Cody engaged in conduct inconsistent with just and equitable principles of trade.

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the time of the recommendation. Profit is not a defense to a suitability violation. *See supra* note 25 and accompanying text.

[49] *Katz*, 97 SEC Docket at 25097.

[50] *Dan Adlai Druz*, 52 S.E.C. 416, 421-22 (1995), *aff'd*, 103 F.3d 112 (3d Cir. 1996) (table).

[51] During the proceedings below, Cody made various attempts to avoid responsibility for the misleading nature of the statements. However, "[a]s a registered securities professional and the author of the [documents]," we hold Cody "responsible for [their] contents," and "reject [his] attempt[s] to shift responsibility . . . for the content of a document that he himself created." *Klein*, 52 S.E.C. at 1034 & 1035.

2. Form U4

It is undisputed that Cody failed to update timely his Form U4 to disclose the two Customer settlements. In so doing, he engaged in conduct inconsistent with just and equitable principles of trade. Registered representatives are required to keep a current and accurate Form U4 on file with FINRA at all times. The failure to update this form "undermines [FINRA]'s ability to carry out its self-regulatory functions,"[52] and frustrates attempts by customers "who are or may be interested in doing business with [the registered person]" from gathering "accurate disclosure information" about such person.[53] Accordingly, a failure to provide such updated disclosure is inconsistent with the just and equitable principles of trade to which every person associated with a FINRA member is held.[54] Among the information required to be disclosed at the time was any "investment-related, customer-initiated complaint" alleging "sales practice violations" if "the complaint was settled for an amount of $10,000 or more." The Form U4 was required to be updated within 30 days of such a settlement.

Before the Hearing Panel, Cody argued that a former Leerink compliance officer advised him that a Form U4 amendment was not required following the two Customer settlements and that he asked GunnAllen to amend the Form U4. However, a registered representative cannot shift responsibility for compliance requirements to his firm or supervisor.[55]

IV.

Cody raises a number of procedural objections to the FINRA disciplinary action primarily related to the suitability violations. He argues that: (a) the investigation of his conduct was inadequate; (b) he was improperly denied the opportunity to present documentary evidence and testimony, including from an expert witness; (c) he was not given sufficient notice of the nature of the charged suitability violations regarding the Credit Suisse Securities; and (d) the disciplinary action was tainted by "bias" and "abuse of process." We evaluate these claims to determine whether FINRA met its Exchange Act obligations to apply a "fair procedure" and to

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[52] *Richard J. Lanigan*, 52 S.E.C. 375, 378 (1995).

[53] NASD Notice to Members Amendments to Section 4 of Schedule A to the NASD By-Laws, February 2004, available at http://www.complinet.com/file_store/pdf/rulebooks/0409ntm.pdf

[54] *Scott Mathis*, Exchange Act Rel No. 61120 (Dec. 7, 2009), 97 SEC Docket 23228, 23235, *appeal filed*, No. 10-429 (2d Cir. Feb. 3, 2010).

[55] *Guang Lu*, 58 S.E.C. 43, 56 (2005), *aff'd*, 179 F. App'x 702 (D.C. Cir. 2006) (unpublished); *Lanigan*, 52 S.E.C. at 378 n.13 ("Participants in the securities industry must take responsibility for compliance [with regulatory requirements] and cannot be excused for lack of knowledge, understanding, or appreciation of these requirements."); *see also infra* note 63.

"bring specific charges, notify [the charged person], and give him an opportunity to defend against, such charges."[56]

A. FINRA Investigation

Cody argues that FINRA conducted a "grossly incomplete investigation" by, among other things, giving him insufficient notice that he was a target, not "attribut[ing] any validity to [his] response to the Wells notice," and not affording him a sufficient opportunity to respond to information gathered in the investigation. He also contends that FINRA was required to acquire additional documentation and investigative testimony before issuing the Complaint.

We reject these contentions. Section 15A(b)(8) of the Securities Exchange Act of 1934 requires SROs to provide a "fair procedure" in an adjudicatory proceeding. This statutory requirement does not extend to investigations.[57] For example, FINRA, as an SRO, is not required to provide a registered person "with actual notice of an investigation into [the registered person's] conduct."[58] The purpose of an investigation is to "determine whether the [SRO's] investigation has produced evidence meriting further proceedings"[59] – not to determine whether a violation has actually occurred.

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[56] Exchange Act Section 15A(b)(8), 15 U.S.C. § 78*o*-3(b)(8); Section 15A(h)(1), 15 U.S.C. § 78*o*-3(h)(1). Cody claims that FINRA's investigation and disciplinary proceedings violated "United States Constitution Due Process protections." However, FINRA is a private actor, and accordingly is not bound by governmental constitutional and common law due process requirements. *See Desiderio v. NASD*, 2 F. Supp. 2d 516, 519 (S.D.N.Y. 1998), *aff'd*, 191 F.3d 198 (2d Cir. 1997); *Datek Sec. Corp. v. NASD*, 875 F. Supp. 230, 233 (S.D.N.Y. 1995) ("The NASD is a private corporation not subject to the strictures of the Constitution.").

[57] *Cf. Kevin Hall*, Exchange Act Rel No. 61162 (Dec. 12, 2009), 97 SEC Docket 23679, 23714 (noting that respondents' "attempt to extend procedural protections for adjudications to the investigation [was] misguided"); *see also* NASD Rule 9211(c) (stating that a "disciplinary proceeding shall begin when the complaint is served and filed").

[58] *Gold v. SEC*, 48 F.3d 987, 991 & 992 (7th Cir. 1995); *cf. Marshall v. Jerrico*, 446 U.S. 238, 248 (1980) (stating that the neutrality requirements "designed for officials performing judicial or quasi-judicial functions[] are not applicable to those acting in a prosecutorial or plaintiff-like capacity"); *Thomas E. Warren, III*, 51 S.E.C. 1015, 1020 (1994) (rejecting claim that SRO failed to conduct an "adequate investigation"), *aff'd*, 69 F.3d 549 (10th Cir. 1995) (table); *Frank J. Custable, Jr.*, 51 S.E.C. 855, 862 (1993) (finding that alleged bias of SRO investigator did not affect fairness of proceedings); *David D. Esco, Jr.*, 46 S.E.C. 1205, 1207 n.7 (1978) (same).

[59] *David C. Ho*, Exchange Act Rel. No. 54481 (Sept. 22, 2006), 88 SEC Docket 3194, 3200, *aff'd*, 2007 WL 1224027 (7th Cir. 2007) (unpublished).

B. Records and Testimony

Cody asserts that the Hearing Panel's refusal to grant his motion to obtain certain documents and testimony rendered the proceedings unfair. Before the hearing, Cody moved FINRA to compel production of a number of categories of Leerink documents pursuant to Rule 9252.[60] He requested and obtained Leerink phone records, copies of Leerink written supervisory procedures, compliance questionnaires, and customer files. The Department objected to several of his other Rule 9252 requests, however, including his requests for order tickets and Bloomberg communications. The hearing officer denied these additional requests, finding that Cody had failed to demonstrate that the documents sought would be relevant and material to the issues in the proceeding, that the requests were vague and overbroad and, in light of the minimal relevance of the documents, that the "the requests would impose a substantial and undue compliance burden on Leerink." Cody has not explained why he believes the hearing officer erred in denying these requests, nor has he established that any of the additional documentary evidence he sought would have aided in his defense of this proceeding.[61]

Cody also complains that FINRA failed to compel testimony from Skelly and Leerink management, and speculates that such persons might have offered testimony demonstrating the involvement or culpability of Skelly, his supervisors, or the Firm for his recommendations. However, Cody testified regarding the involvement of others at Leerink, including Skelly and other Leerink managers, in his trades. In any event, such testimony would not mitigate Cody's

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[60] As relevant here, a Rule 9252 request will be evaluated to determine whether the information or testimony is relevant, material, and non-cumulative; whether FINRA has jurisdiction over the sources of such documents or testimony; and "whether the request is unreasonable, excessive in scope, or unduly burdensome." Disciplinary proceedings by SROs such as FINRA do not provide for subpoenas. *Warren*, 51 S.E.C. at 1020 n.22.

[61] Cody asserts that the record should have included additional monthly statements, confirms, and order tickets, asserting that these types of documents are required in any disciplinary proceeding. However, he does not specify any information on these documents that would have excused or disproved the charged violations, particularly when the record includes: other documents that Cody admitted were consistent with the confirms, monthly statements for the periods and accounts at issue in this case, and testimony and documentary evidence regarding the confirms and the trading process. *See Kirlin Securities, Inc.*, Exchange Act Rel. No. 61135 (Dec. 10, 2009), 97 SEC Docket 23299, 23332 ("Because Applicants have failed to establish what information they were denied and how that denial prejudiced their case, we reject Applicants' argument that the proceedings against them were procedurally flawed."); *Gateway Stock & Bond*, 43 S.E.C. at 195 & n.9 (rejecting due process argument because "applicants have not shown that they were prejudiced by the manner in which evidence was presented . . . or that any material evidence was not produced."); *Epstein*, 95 SEC Docket at 13860 n.54 (noting that respondent "is not 'entitled to conduct a fishing expedition . . . in an effort to discover something that might assist him in his defense'. . . or 'in the hopes that some evidence will turn up to support an otherwise unsubstantiated theory'" (internal citations omitted)).

misconduct[62] because, as noted above, Cody had an independent obligation to comply with the provisions at issue here and cannot shift this responsibility to others.[63]

In addition, Cody argues that FINRA improperly denied him the opportunity to present expert witness testimony. He contends that his expert would have addressed, among other things: errors on Leerink statements and other exhibits and calculations; Leerink's responsibility for Cody's recommendations; and the propriety of his trading strategy. He also claims that the expert would have testified regarding the differences between ABSs and collateralized mortgage obligations (CMOs) and whether Cody's trading was excessive.

In determining whether securities law violations have occurred, "neither we nor NASD is hindered by the lack of, or is bound by, expert testimony."[64] The Hearing Panel and the NAC act as expert bodies whose 'businessman's judgment' may be brought to bear in reaching . . . decision[s]"[65] based on their "collective business experience."[66] In reviewing disciplinary action taken by an SRO, we are not bound to admit or consider expert testimony.[67]

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[62] *See Kirlin Sec.*, 97 SEC Docket at 23331 (finding no irregularity in FINRA exclusion of testimony that was "unlikely to have added to the description of the market activity . . . already provided by Applicants"); *Ronald Pellegrino*, Exchange Act Rel. No. 59125 (Dec. 19, 2008), 94 SEC Docket 12628, 12652 & nn.56-57 (finding that the fairness of NASD disciplinary action was not compromised by exclusion of testimony by NASD employee that was not "relevant and material" when respondent testified about conversations with the NASD employee); *A.S. Goldman & Co*, 55 S.E.C. 147, 168-69 (2001) (rejecting due process challenge based on exclusion of testimony that was "not probative" of the violations charged); *U.S. Sec. Clearing Corp.*, 52 S.E.C. 92, 100-01 (1994) (rejecting challenge based on exclusion of NASD employee testimony when "testimony [was] irrelevant" because "these violations are amply supported by the record" and applicant "was permitted to testify about these conversations").

[63] *See Audifferen*, 93 SEC Docket at 8141 (noting that applicant "cannot shift the blame for his violations to his firm"); *Barry C. Wilson*, 52 S.E.C. 1070, 1073 n.12 (1996) (noting that "failings on the part of certain firm personnel do not excuse misconduct by others").

[64] *Kirlin Sec.*, 97 SEC Docket at 23321 n.74.

[65] *Meyer Blinder*, 50 S.E.C. 1215, 1222 n.32 (1992).

[66] *Reynolds*, 50 S.E.C. at 809.

[67] *Kirlin Sec.*, 97 SEC Docket at 23321 n.74; *see also Gregory M. Dearlove*, Exchange Act Rel. No 57244 (Jan. 31, 2008), 92 SEC Docket 1867, 1897-98, *petition denied*, 573 F.3d 801 (D.C. Cir. 2009) (stating that "the SEC need not have received expert testimony to establish the standard of care [for accountants] or to determine whether Dearlove's conduct was unreasonable"); *Christiana Sec. Co.*, 45 S.E.C. 648, 659-60 n.38 (1974) (declining to resolve issue through use of financial expert opinions when "the questions presented were . . . essentially legal" and "cannot be resolved by reference to the opinions of financial experts, however

Cody first sought to introduce expert testimony by designating an expert on the witness list he filed on October 3, 2008, several weeks before the hearing. He asserted that the expert testimony would "help clarify . . . fixed income (1) products; (2) trading desk procedures; (3) investment methodologies[;] (4) ratings; and (5) the specific investments in the client's accounts." The Department objected, arguing that the May 9, 2008 deadline for motions for leave to offer expert testimony established in the scheduling order had long passed, and that the Department would not have sufficient time before the hearing to prepare to cross-examine or rebut such testimony. During a pre-hearing conference, the hearing officer noted the Hearing Panel's "very extensive experience in the securities industry" and familiarity with the proposed topics of expert testimony, and that Cody had not submitted an expert report to "explain[] in detail what the expert's proposed testimony would be in advance of the hearing." The full Hearing Panel considered the expert testimony as then proposed by Cody, and in a pre-hearing order dated October 20, 2008, unanimously concluded that such expert testimony "would not be necessary or helpful to the Panel in resolving the issues in this proceeding."[68] Cody renewed his request for expert testimony at the beginning of the hearing. The Hearing Officer again denied the request, but suggested that the panel might reconsider the motion if it saw "something [during the hearing] that the expert's expertise would be really helpful to us and our need to understand the case." Cody did not renew the request after the cross-examination of the FINRA examiner. During the NAC appeal, Cody sought an extension of the deadline to file a motion for leave to offer expert testimony to the NAC. Under NASD Rule 9346(b) such a motion requires a showing of "good cause." NAC denied Cody's motion, which again did not include a report detailing the expert's testimony.

Cody cites *Shad v. Dean Witter Reynolds, Inc.*, for the proposition that expert testimony is required to evaluate any charge of excess trading.[69] That case, however, is inapposite. *Shad* dealt with the inability of a lay jury to evaluate investment risk, suitability, trading patterns, and otherwise "meaningless numbers from which they cannot judge the appropriateness of the

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conscientious and however eminent."); *IMS/CPAs & Assocs.*, 55 S.E.C. 436, 460 & n.45 (2001) (finding that the accuracy of responses on a Form ADV "goes directly to the issue of whether a violation occurred" and deeming such issue "a legal question within the purview of the law judge and the Commission to determine").

[68] NASD Rule 9263(c) – now recodified as FINRA Rule 9263(a) – permits the exclusion of "irrelevant, immaterial, unduly repetitious or unduly prejudicial" evidence.

[69] 799 F.2d 525 (9th Cir. 1986).

transactions."[70] Both FINRA and the Commission, however, have the expertise to evaluate such evidence without expert testimony.[71]

Cody suggests that expert testimony would have addressed errors on the Leerink statements exhibits and other exhibits. However, Cody was given wide latitude during cross-examination of the FINRA examiner to address these purported errors and to argue for the exclusion of Division exhibits and calculations. He also submitted his own exhibits illustrating his trading. Based on our review of Cody's claims and the evidence, we find that Cody has not substantiated a need for expert testimony.[72]

C. Notice of the Suitability Charges Regarding the Credit Suisse Securities

Cody also claims that he was not afforded sufficient notice to offer a defense to the charge that his recommendation of the Credit Suisse Securities violated the suitability rule. In advancing this notice argument, Cody focuses on the fact that the Credit Suisse Securities have been characterized variously as CMOs and as ABSs during the FINRA proceedings. The Complaint that initiated the FINRA proceedings described the Credit Suisse Securities as "Credit Suisse First Boston Indymac 7.105% 2028 Collateralized Mortgage Obligation securities (CSFB CMO)." The testimony and briefs in the FINRA proceedings and the Hearing Panel decision generally refer to the Credit Suisse Securities as CMOs.[73] On appeal, the NAC concluded that the Credit Suisse Securities were more appropriately characterized as ABSs rather than CMOs because they were collateralized by installment loan agreements.

Cody claims that, given the NAC's characterization of the Credit Suisse Securities as ABSs, he was denied notice and an opportunity to offer a defense based on the "different

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[70] *Id.* at 530. Cody also cites *Costello v. Oppenheimer & Co.* for the proposition that experts are "customar[ily] . . . call[ed]" in churning cases considered by the courts "to testify on the question of whether excessive trading has taken place." 711 F.2d 1361, 1369 (7th Cir. 1983). The court in *Costello*, like *Shad*, dealt with a churning decision made by a jury. The court ultimately found that the jury was entitled to find churning without considering expert testimony.

[71] Cody argues that the NAC decision regarding expert testimony supports his contention that he should have been allowed to introduce expert testimony. However, the NAC found that such testimony would have been helpful on only one issue – whether the Credit Suisse Securities were speculative despite the investment grade rating when purchased. Cody was not prejudiced because, given the lack of evidence on this issue, the NAC declined to find that the Credit Suisse Securities were speculative.

[72] *See also* discussion of our review of FINRA exhibits in text preceding note 43 *supra*.

[73] Certain documents in the record (including Cody's pre-hearing memorandum, the Leerink statements, and Cody's testimony) describe the Credit Suisse Securities as ABSs.

investment benefits, different risk factors and different previous investment experience by the clients and Cody" applicable to ABSs rather than CMOs.[74] We do not find merit in this argument. Notice is sufficient in a disciplinary proceeding "[a]s long as the party . . . is reasonably apprised of the issues in controversy"[75] and "is afforded a full opportunity" to address the charged violations.[76] Here, Cody had notice of the basis for the charged suitability violations and which Credit Suisse Securities were at issue. The Complaint alleged that Cody recommended the Credit Suisse Securities "without having reasonable grounds for believing that the securities were suitable," and cited his failure to "conduct any due diligence" on the security. Cody admitted at the hearing that he did not understand the Credit Suisse Securities when he made the recommendations, and this admission was sufficient to establish the suitability violations regardless of whether the securities were ABSs or CMOs. Moreover, Cody has never claimed any confusion about which Credit Suisse Securities were at issue.[77] We find that Cody

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[74] The definition of "asset-backed securities" in Section 3(a)(77) of the Exchange Act includes collateralized mortgage obligations. 15 U.S.C. § 78c(a)(77)(A)(i) (defining ABS as "a fixed-income or other security collateralized by any self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including – (i) a collateralized mortgage obligation . . . ").

[75] *Steven E. Muth*, 58 S.E.C. 770, 792-93 n.40 (2005) (finding that allegation provided sufficient notice where it alleged applicant "engaged in various sales practice violations," but "did not specify unauthorized trades"); *see also Rita J. McConville*, 58 S.E.C. at 627 (noting that NYSE "need not disclose to the respondent the evidence upon which [it] intends to rely" if it provides enough detail for the respondent to prepare a defense).

[76] *See Piontek*, 57 S.E.C. at 90-91 (finding that respondent who "understood the issue[s]" and "'was afforded full opportunity' to litigate" had sufficient notice of the charges (quotations and citations omitted)); *KPMG Peat Marwick*, 55 S.E.C. 1, 4 (2001) ("As long as a party to an administrative proceeding is reasonably apprised of the issues in controversy and is not misled, notice is sufficient."), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002); *cf. Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979) (noting that, in administrative proceedings, "[i]t is sufficient if the respondent 'understood the issue' and 'was afforded full opportunity' to justify its conduct during the course of the litigation").

In general, "administrative pleadings are very liberally construed," and courts accord agencies considerable latitude to interpret charging documents. *National Realty & Construction Co. v. ASHRC*, 489 F.2d 1257, 1264 (D.C. Cir. 1973). Thus, the "question on review is not the adequacy of the pleadings . . . but is the fairness of the entire procedure." *Aloha Airlines*, 598 F.2d at 262 (quoting 2 K. Davis, Administrative Law Treatise, § 8.04 (1958)).

[77] Bloomberg printouts and monthly Leerink statements in the record identify the full title and CUSIP number of the Credit Suisse Securities, and Cody submitted exhibits illustrating his trades in these securities.

had a full opportunity to address the charge that his recommendations of the Credit Suisse Securities were unsuitable.

D. Other Procedural Claims

Cody's other procedural objections are similarly without merit. Asserting "inconsistent and abusive behavior by FINRA," he argues that FINRA did not bring a disciplinary proceeding against other persons who recommended similar transactions. To the extent that Cody claims to be a victim of selective prosecution, he must establish that he was a member of a protected class under the Equal Protection Clause, that "prosecutors acted with bad intent, [and] that similarly situated individuals outside the protected category were not prosecuted."[78] Cody has not made these required showings. To the extent that he argues that FINRA was motivated by bias or an improper desire to punish him, we do not find evidence of bias or that Cody was treated unfairly during the FINRA proceedings. In addition, our *de novo* review of the evidence cures whatever bias, if any, that may have existed.[79]

Cody asserts that the Department's appeal to the NAC did not specify the basis for its appeal. We find that the Department's notice adequately described its appeal of "sanctions, including specifically the Panel's declining to order restitution." Moreover, the NAC subsequently notified the parties that its decision could cover "all substantive, procedural, and sanctions-related issues." The Department also made its contentions clear in its briefs to the NAC.

Finally, Cody argues that the Hearing Panel and the NAC decisions were unduly delayed, and that the decisions were not served by the deadlines set by the applicable rule. Rule 9268 establishes a sixty-day limit for the preparation of a hearing panel decision.[80] However, this time frame applies to the hearing officer's distribution of the draft opinion to other hearing panel members, not the issuance of the hearing panel decision.[81] Cody has not shown that this limit

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[78] *Fog Cutter Capital Group Inc. v. SEC*, 474 F.3d 822, 826 (D.C. Cir. 2007).

[79] *Robert Bruce Orkin*, 51 S.E.C. 336, 344 (1993) (finding that the Commission's "*de novo* review . . . cures whatever bias or disregard of precedent or evidence, if any, that may have existed below"), *aff'd*, 31 F.3d 1056 (11th Cir. 1994).

[80] Cody argues that "the rules require [the Hearing Panel decision] to be served in 90 days," but does not cite a specific rule as the basis for this claim.

[81] *Howard*, 55 S.E.C. at 1104. Rule 9348 sets forth the framework for service of the NAC decision to the parties.

was contravened, or that either alleged delay resulted from any lack of diligence on FINRA's part or caused him prejudice.[82]

V.

On appeal, Cody challenges the one-year suspension and a $20,000 fine imposed by the NAC for the suitability violations.[83] Exchange Act Section 19(e) directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[84] For the violations of the suitability rule, FINRA referenced its Sanction Guidelines recommending a fine between $2,500 and $75,000, suspension for a period of ten business days to one year and, in egregious cases, a longer suspension of up to two years or a bar.[85]

Cody engaged in repeated violations of the suitability rule that warrant serious sanctions. He recommended that Mr. Bates and the DeSimones invest considerable amounts of their retirement savings in a security that he did not understand. His recommendations of non-investment grade securities for Mr. Bates did not conform to Mr. Bates' clearly stated conservative investment goals and low risk tolerance. Cody also used his control over Mr. Bates' and Ms. DeSimone's accounts to pursue short-term, excessive trading that was inconsistent with their investment objectives and needs.

Numerous aggravating factors support the sanctions. As FINRA found, Cody's violations amounted to a "pattern of misconduct over an extended period of time," were "significant," especially in light of the size and nature of the accounts, and generated commissions for Cody.

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[82] Nor has Cody established that he suffered any prejudice because the Hearing Officer indicated his belief that Cody's conduct justified a six-month suspension in a footnote rather than a dissent.

[83] Cody does not challenge the fines for the Form U4 and spreadsheet violations. FINRA consulted the Sanction Guidelines, which recommend a fine from $2,500 to $25,000 for a failure to file a Form U4 amendment, and a fine from $5,000 to $100,000 for falsification of records. The fines imposed by FINRA ($2,500 for the Form U4 violation and $5,000 for the spreadsheet violations) are at the low end of these guidelines, and we find them neither excessive nor oppressive and in the public interest.

[84] 15 U.S.C. § 78s(e)(2).

[85] FINRA Sanction Guidelines at 99 (2007 ed.). "Although the Commission is not bound by the Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2)." *CMG Institutional Trading, LLC*, Exchange Act Rel. No. 53925 (Jan. 30, 2009), 95 SEC Docket 13802, 13814 n.38; *Paz Sec., Inc.*, Exchange Act Rel. No. 57656 (April 11, 2008), 93 SEC Docket 5122, 5125, *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009).

Moreover, the Customers were elderly, retired or near retirement, not sophisticated "when it came to bond trading and active trading," and did not understand how the market values of their accounts were determined. The Customers entrusted Cody with considerable discretion over their retirement savings and, based on Cody's assurances, believed that he was acting in their interest.

We are particularly troubled by Cody's responses to Customer questions, which often suggested efforts to deflect their legitimate concerns and lull them into inaction. These efforts to lull the customers into inactivity or mislead the customers aggravate the seriousness of Cody's suitability violations.[86] For instance, when Mr. Bates asked about a sharp decline in the value of the Credit Suisse Securities in the summer of 2003, Cody told him not to worry. He suggested that the decline did not affect "[Mr. Bates'] particular bond" even though other evidence confirms that the market for the Credit Suisse Securities was then sharply declining. When Ms. DeSimone inquired about the Credit Suisse Securities in November 2003, Cody told her "Don't worry about it. Everything is safe." When Ms. DeSimone asked Cody about frequent trading in her account in late 2003 or early 2004, Cody responded, "Don't worry about it. It is going to work out." In addition, when the Customers expressed concern over their losses in the Credit Suisse Securities in 2004, Cody suggested that they would be reimbursed. Cody also discouraged the Customers from reviewing Leerink statements that included information omitted from or obscured by Cody's spreadsheets. Cody's misleading responses to Customers questions, together with his attempts to shift blame for his recommendations to others, demonstrate a fundamental misunderstanding of his responsibilities as a securities professional.

Cody argues that his settlements with the Customers mitigate the seriousness of his violations, and that he should be credited for settling against the recommendation of his attorney and before the Customers had "registered a formal complaint." The Sanction Guidelines, however, provide that a representative's acknowledgment and attempts to remedy misconduct are mitigating if made "voluntarily and reasonably" and "prior to detection and intervention."[87] These guidelines are not satisfied. Cody entered into the settlements, which were drafted and recommended by a Firm compliance officer, after the Customers complained and the Firm investigated.

Cody challenges the NAC's decision to increase the suspension from three months to a year, asserting that it was based on the NAC's characterization of the Credit Suisse Securities as ABSs. As discussed above, we find no merit to this claim. Moreover, we have repeatedly held

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[86] Sanction Guidelines at 6; *see also Pinchas*, 54 S.E.C. at 348 n.40 (stating that "[i]f a respondent commits more serious misconduct during the excessive trading, such as attempting to lull the investor, or being untruthful about the transactions, the respondent may face a longer suspension or a bar"); *Bucchieri*, 52 S.E.C. at 806 (noting SRO guidelines calling for "a suspension or bar in cases involving serious misconduct such as excessive trading in more than one account or attempts to lull investors").

[87] Sanction Guidelines at 6.

that the NAC reviews hearing panel decisions *de novo* and has broad discretion to review hearing panel decisions and sanctions.[88] The procedural rules expressly authorize the NAC to increase sanctions.[89]

Cody also complains that FINRA declined to discipline other registered representatives when it settled charges that another member firm failed to implement an adequate supervisory system and procedures relating to its representatives' recommendations of CMOs to retail customers. It is well established, however, that the appropriateness of a sanction "depends on the facts and circumstances of each particular case and cannot be precisely determined by comparison with the action taken in other proceedings."[90] This is especially true with regard to

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[88] *See Michael B. Jawitz*, 55 S.E.C. 188, 200 & n.24 (2001) (stating that the NAC conducts a *de novo* review and has broad discretion to review any finding in the Hearing Panel decision) (citing *Timothy L. Burkes*, 51 S.E.C. 356, 359 (1993), *aff'd*, 29 F.3d 630 (9th Cir. 1994) (table)); *cf. Morton Bruce Erenstein*, Exchange Act Rel. No. 56768 (Nov. 8, 2007), 91 SEC Docket 3114, 3126 (acknowledging NAC's power to conduct a *de novo* review and make independent findings), *petition denied*, No. 07-15736 (11th Cir. 2008) (unpublished); *see also Chris Dinh Hartley*, 57 S.E.C. 767, 776 (2004) (finding NASD's sanctions not excessive or oppressive where the NAC increased a suspension imposed by hearing panel from thirty days to ninety days for selling away violation); *James B. Chase*, 56 S.E.C. 149, 162 (2003) (finding NASD's sanctions not excessive or oppressive where NAC increased hearing panel's suspension from six months to one year for violations involving unsuitable recommendations).

[89] NASD Rule 9348; *Joseph Abbondante*, 58 S.E.C. 1082, 1111 (2006), *aff'd*, 209 F. App'x 6 (2d Cir. 2006). We also reject Cody's various arguments for remand to the NAC or a hearing panel. We conduct a *de novo* review of the NAC decision, and the findings herein are based on the record evidence. *See John M.E. Saad*, Exchange Act Rel. No. 62178 (May 26, 2010), 98 SEC Docket 28591, 28599 n.12 ("we review only the NAC's decision on appeal"), *appeal filed*, No. 10-1195 (D.C. Cir. July 23, 2010); *Philippe N. Keyes*, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 800 n.17 ("[I]t is the decision of the NAC, not the decision of the Hearing Panel, that is the final action of NASD which is subject to Commission review.").

[90] *Paz Sec.*, 93 SEC Docket at 5134 (citing *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) ("The employment of a sanction within the authority of an administrative agency is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases.")), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009); *see also Geiger v. SEC*, 363 F.3d 481, 488 (D.C. Cir. 2004) ("The Commission is not obligated to make its sanctions uniform, so we will not compare this sanction to those imposed in previous cases."); *Hiller v. SEC*, 429 F.2d 856, 858 (2d Cir. 1970) ("[W]e cannot disturb the sanctions ordered in one case because they were different from those imposed in an entirely different proceeding.").

settled cases, like the one cited by Cody, "where pragmatic factors may result in lesser sanctions."[91]

Cody further argues that these proceedings create an unnecessary or inappropriate burden on competition by discouraging voluntary settlements and employment in the securities industry. As we have previously held, these factors are "not the type of competitive concern that Exchange Act Section 19 meant to be considered."[92] The "unnecessary or inappropriate burden on competition" requirement was added to Section 19 to "break down the unnecessary regulatory restrictions which . . . restrain competition among markets and market makers . . . ."[93] In disciplining those who make unsuitable recommendations, FINRA is fulfilling its Exchange Act mandate "to promote just and equitable principles of trade . . . and, in general, to protect investors and the public interest"[94] by encouraging competition based on appropriate sales practices.

Cody's conduct raises serious questions about his commitment to future compliance with the suitability requirements. Given the seriousness of each of Cody's suitability violations, we find that the relatively lenient one-year suspension and $20,000 fine for these violations will protect the public interest by encouraging Cody and others to take the steps necessary to appropriately investigate the investments they recommend, and to tailor recommendations to the objectives and risk tolerances of their customers. Accordingly, we find that these sanctions do

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[91] *Anthony A. Adonnino*, 56 S.E.C. 1273, 1295 (2003), *aff'd*, 111 F. App'x 46 (2d Cir. 2004); *see also Gary Kornman*, Exchange Act Rel. No. 59403 (Feb. 19, 2009), 95 SEC Docket 14246, 14260-61 (affirming bar and rejecting applicant's comparison to an allegedly similar, settled matter that involved a lesser sanction), *aff'd*, 592 F.3d 173 (D.C. Cir. 2010).

[92] *Howard Brett Berger*, Exchange Act Rel. No. 58950 (Nov. 14, 2008), 94 SEC Docket 11615, 11634, *petition denied*, 2009 WL 3160620 (2d Cir. 2009).

[93] S. Rep. No. 94-75 at 12-13 (1975); *see* Securities Reform Act of 1975, Pub. L. No. 94-29, 89 Stat. 97 (codified as amended in scattered sections of 15 U.S.C.).

[94] 15 U.S.C. § 78*o*-3(b)(6); *see also Berger*, 94 SEC Docket at 11634 n.73. Cody also requests "reimbursement for attorney fees and costs." We see no reason for awarding costs to Cody since, as discussed herein, FINRA was amply justified in bringing this proceeding. In any event, he has cited to no basis for the awarding of costs to an applicant, and we are unaware of any such provision. *See N. Woodward Fin. Corp.*, Exchange Act Rel. No. 60505 (Aug. 14, 2009), 96 SEC Docket 19837, 19847 n.29.

not impose an unnecessary or inappropriate burden on competition and are neither excessive nor oppressive.

An appropriate order will issue.[95]

By the Commission (Commissioners CASEY, AGUILAR, and PAREDES); Chairman SCHAPIRO and Commissioner WALTER not participating.

Elizabeth M. Murphy
Secretary

[95] We have considered all of the arguments advanced by the parties. We reject or sustain them to the extent that they are inconsistent or in accord with the views expressed herein.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 64565 / May 27, 2011

Admin. Proc. File No. 3-13932

In the Matter of the Application of

RICHARD G. CODY
c/o Stephen Z. Frank, Esq.
P.O. Box 129
North Conway, NH 03860

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken, and the costs imposed, by FINRA against Richard G. Cody, be, and they hereby are, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary