BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of District Business Conduct Committee For District No. 10 Complainant, vs. Rafael Pinchas Hillcrest, New York, Respondent.	DECISION Complaint No. C10930017 District No. 10 Dated: June 12, 1998

Rafael Pinchas ("Pinchas") appealed the June 2, 1997 decision of the District Business Conduct Committee for District No. 10 ("DBCC") pursuant to NASD Procedural Rule 9310. After a review of the entire record in this matter, we hold that Pinchas made unsuitable recommendations and engaged in excessive trading in violation of Conduct Rules 2110, 2120, 2310, 2510 and 2860. In addition, we find that Pinchas misappropriated customer funds in violation of Rules 2110 and 2330. We order that Pinchas be censured, fined $219,821 and barred from associating with any member of the NASD in any capacity.

Background

Pinchas has been registered with the NASD as a general securities representative since June of 1984. He was registered as such with PaineWebber, Inc. from June of 1984 through April of 1989. From May of 1989 through May of 1990, he was registered with Prudential-Bache Securities, Inc. ("Prudential"). Beginning in May of 1990 and lasting until July of 1992, he was registered with Lew Lieberbaum & Co., Inc. ("Lieberbaum"). Pinchas is not currently associated with any member firm.

Facts

The complaint in this matter covers conduct which occurred between July of 1989 and August of 1991. The conduct in question involved two distinct customer accounts, each of which will be discussed separately below.

Customer W. Customer W is a deaf individual who immigrated to the United States from Taiwan in 1985 with her husband and three children. She testified at the DBCC hearing that in 1989, when she opened an account with Pinchas, she was unable to read or write in English and her command of American Sign Language was not very good. She testified further that she did not understand the account statements that she received from Pinchas. In fact, she stated that, after a while, she stopped opening envelopes from Pinchas because she could not read or understand the information contained in them. She also testified that Pinchas would often give her documents to sign without explaining them and would tell her that she had to sign them.

During the relevant period, customer W worked as a service attendant at the Marriott Hotel in midtown Manhattan. Her husband worked part-time as a carpenter and painter. The income tax returns of customer W and her husband for the years 1988 through 1990 indicate that their total annual income for those years was $6,845, $19,652 and $19,202 respectively. According to the new account card that Pinchas filled out for customer W when she opened an account with him at Prudential in December of 1989, her annual income was $14,000 and her net worth, excluding residence, was $50,000. The new account form also indicated that her investment objective was long-term growth. Customer W testified that, other than receiving certain Marriott stocks through an employee stock-compensation plan, she did not have any experience investing in stocks, bonds or options prior to opening an account with Pinchas at Prudential.[1] In a letter to the NASD dated July 15, 1991, Pinchas acknowledged that customer W had no previous investment experience. Customer W also testified that when she opened her account with Pinchas, he told her that she would earn interest of $7,500 on her $48,929.39 investment, a statement which Pinchas denied.

While at Prudential, customer W's account was characterized by frequent trading and purchases and sales of the same securities. The following securities were all bought and sold during the six months that the account was at Prudential: AT&T,

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[1] In fact, customer W testified that her only previous individual investment choice was the purchase of a certificate of deposit ("CD") at The Chase Manhattan Bank in New York, where she had an account. She stated, moreover, that she opened the bank account and purchased the CD with the assistance of her sister-in-law, who helped her fill out the required forms.

Ferro Corp, Federal National Mortgage Association ("FNMA"), Global Util Fund, Home Shopping Network and MCI. The account was particularly active in FNMA warrants.[2] During the time that the account was open at Prudential, there were 17 purchases and 13 sales. Fourteen of these 30 transactions were in FNMA warrants or common stock. The account bought and sold FNMA warrants four times.

In 1990, Pinchas moved to Lieberbaum and transferred customer W's account there. The new account form at Lieberbaum indicated that customer W's investment objective was growth. The account at Lieberbaum, unlike the one at Prudential, was discretionary, since customer W could not easily visit the Lieberbaum office on Long Island.

While at Lieberbaum, the account was extremely active in buying and selling call options.[3] During the eight months that the account was at Lieberbaum, there were 35 purchases, of which 33 were options purchases. There were also 28 sales, of which 19 were options sales. Of the remaining 11 transactions, six were in FNMA warrants.

Customer S. Customer S opened an account with Pinchas at Prudential on July 27, 1989. At that time, she was 47 years old with no dependents. Like customer W, customer S is a deaf individual. She attended a grammar school for the deaf and then a hearing high school for three years. She then attended a vocational school to learn keypunch skills. After school, she worked as a keypunch operator at several companies for nine and one-half years. She has not worked since the early 1970's.

When she opened an account with Pinchas in 1989, customer S had an income in the range of $30,000 to $60,000 and a net worth of $500,000. The income was derived from her securities account, interest on bank accounts, an investment in a parking garage and Social Security.

Prior to opening the account with Pinchas, customer S had owned securities for a number of years, primarily in a joint account with her father. According to testimony given at the DBCC hearing, when customer S' father grew old and became ill, he began to worry about her and he opened and maintained a joint account on

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[2] A warrant is a type of security that entitles the holder to buy a proportionate amount of common stock at a specified price for a period of years.

[3] A call option provides the right to buy a certain number of shares of a particular stock or stock index at a predetermined price before a preset deadline, in exchange for a premium. A put option grants the right to sell at a specified price a specific number of shares by a certain date.

behalf of himself and customer S, as well as an account solely in her name, at Merrill Lynch Pierce Fenner & Smith Inc. ("Merrill Lynch") with Jeffrey Berman ("Berman"), a hearing broker who knew some sign language. Customer S' father asked Berman to take care of the accounts he had established for his daughter. At the DBCC hearing, Berman testified that customer S' father made all of the investment decisions in all of these accounts.

After the death of customer S' father in April of 1988, customer S' account was essentially inactive for a year and a half. In the fall of 1989, at Berman's recommendation, customer S opened a wrap account with a portfolio manager.[4] Customer S thereafter transferred the account to Pinchas.

When customer S first transferred her account to Pinchas at Prudential, the new account card indicated that her investment objective was long-term growth. However, she also signed an option form in July of 1989 that indicated that her investment objective was investment hedging.

While at Prudential, the account was characterized by frequent trading and the purchases and sales of the same securities within a short period of time. Boeing stock was transferred to Prudential from Merrill Lynch, sold and then repurchased within 15 days. Similarly, Summit Technology stock was bought and sold three times in a six-month period. Other securities that were bought and sold repeatedly included Compaq, FNMA warrants, MCI, Microsoft, Motorola, UAL Corp. and Upjohn.

When the account was transferred to Lieberbaum in June of 1990, the new account card signed by customer S indicated that her investment objectives were growth and speculation. Customer S' account, like that of customer W, also became active in trading options, usually buying inexpensive call options shortly before the expiration date. In addition, customer S provided Pinchas with a written trading authorization.

<u>Procedural History</u>

The staff's investigation into Pinchas' activities began in May of 1991, when customer W visited the NASD's New York district office for assistance. Customer W, with the help of a hearing friend of hers who worked as a Chinese translator,

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[4] A wrap account generally refers to an investment consulting relationship in which a customer's funds are placed with one or more money managers, and all administrative and management fees, along with commissions, are "wrapped" into one comprehensive fee, which is usually paid quarterly.

indicated to the staff that she was concerned over the activity in her account with Pinchas.

In February of 1992, the staff conducted an on-the-record interview with customer W. In April of 1992, the NASD staff conducted an on-the-record interview of Pinchas. In May of 1992, the American Stock Exchange informed the NASD about a complaint filed against Pinchas by customer S. When the NASD staff first contacted customer S, however, she declined to cooperate in the investigation of Pinchas. In March of 1993, the NASD staff sent a set of written questions to customer W, which she answered and returned to the staff. Based on the information from the on-the-record interviews and the answers to the written questions, as well as account documentation, the NASD filed a complaint against Pinchas in April of 1993 alleging that he had engaged in misconduct in relation to customer W's account.

The DBCC scheduled a hearing on the Pinchas matter for October of 1993. Shortly before the hearing, however, customer S decided to cooperate with the NASD staff in its investigation of Pinchas. In June of 1993, customer S appeared for an on-the-record interview. As a result of that interview, the October hearing was postponed, and the staff filed an amended complaint, including charges relating to customer S, in February of 1995. A hearing before the DBCC, based on the amended complaint, began on December 13, 1996.

The DBCC hearing lasted 15 days and was held between December of 1996 and March of 1997. The staff introduced the testimony of 10 witnesses, including that of customer W. Customer S did not participate in the hearing. Pinchas introduced the testimony of eight witnesses. In addition, at the request of the hearing panel, the staff arranged for the testimony of the former assistant branch manager at the Prudential office where Pinchas had worked.

Pinchas is a deaf individual. Additionally, many of the witnesses who appeared at the hearing are deaf. In order to accommodate Pinchas and the other deaf witnesses, the staff provided two sign-language interpreters. The staff also arranged for the services of a court reporter who used real-time transcription, which allowed the parties to view the text of the transcript, on one of several computer monitors set up around the room, within seconds of a speaker voicing his or her words.[5] Finally, the staff provided a Mandarin Chinese interpreter for customer W's testimony and Pinchas provided a Russian and Bukharian interpreter for the testimony of one of his witnesses.

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[5] We note that Pinchas requested and was granted the right to select his own sign-language interpreter for the appeal proceeding. The NASD agreed to pay for such interpreter's services. In addition, real-time transcription was used during the appeal proceeding.

Discussion

The amended complaint alleged that Pinchas made unsuitable recommendations and engaged in excessive trading in the accounts of customers W and S. The amended complaint also alleged that Pinchas had misappropriated certain funds of customer W. The provisions applicable to these causes of action are NASD Conduct Rules 2110, 2120, 2310, 2330, 2510, and 2860(b)(19). Rule 2110 requires observation of "high standards of commercial honor and just and equitable principles of trade" and Rule 2120 prohibits associated persons from using "manipulative, deceptive or other fraudulent devices or contrivances" in effecting any transaction in or inducing the purchase or sale of any security. Rule 2330 prohibits representatives from making improper use of a customer's securities or funds. Rule 2310 requires associated persons to have reasonable grounds for believing that a recommendation is suitable for a customer based on his or her financial situation and needs. Rule 2860(b)(19) similarly requires that a recommended options transaction not be unsuitable for the customer. Rule 2510 prohibits an associated person who is vested with discretionary power from effecting purchases or sales that are "excessive in size or frequency in view of the financial resources and character of such account."

The first step in analyzing an action based on excessive trading is to determine whether the representative controlled the account. This element is satisfied if the account is discretionary. See In re Peter C. Bucchieri, Exchange Act Rel. No. 37218, 7 n.11 (May 14, 1996) ("If a broker is formally given discretionary authority to buy and sell for the account of his customer, he clearly controls it.") (citations omitted). The first element can also be satisfied by a showing of de facto control. De facto control of an account may be established where the client habitually follows the advice of the broker. See Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980); In re Gerald E. Donnelly, Exchange Act Rel. No. 36690, at 6 (Jan. 5, 1996); In re Michael H. Hume, Exchange Act Rel. No. 35608, at 6 n.11 (April 17, 1995).

After a showing of control of the account is made, the next step is to determine whether the trading activity was in fact excessive. There is no single test for making such a determination. As the Securities and Exchange Commission ("SEC") has explained, the "assessment of the level of trading . . . does not rest on any 'magical per annum percentage,' however calculated." Gerald E. Donnelly, supra, at 5. Nonetheless, factors such as the turnover ratio,[6] the cost-equity ratio,[7] the

[6] The turnover ratio is calculated by applying the "Looper formula," named after In re Looper & Co., 38 S.E.C. 294 (1958), which divides the total cost of purchases made during a given period by the average monthly investment. See In re Frederick C. Heller, 50 S.E.C. 275, 276-77 (1993). The turnover ratio is computed

use of "in and out" trading,[8] and the number and frequency of trades in an account introduce some measure of objectivity or certainty into the analysis and provide a basis for a finding of excessive trading. See Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369 (7th Cir. 1983); Hecht v. Harris, Upham & Co., 283 F. Supp. 417, 435-36 (N.D. Cal. 1968), modified on other grounds, 430 F.2d 1202 (9th Cir. 1970); In re John M. Reynolds, 50 S.E.C. 805, 808 n.12 (1992).

Turnover rates between three and four, for instance, have triggered liability for excessive trading,[9] and the courts and the SEC have held that there is little question about the excessiveness of trading when an annual turnover rate in an

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"by dividing the aggregate amount of the purchases by the average cumulative monthly investment, the latter representing the cumulative total of the net investment in the account at the end of each month, exclusive of loans, divided by the number of months under consideration." Id. at 279 n.10. A modified Looper formula divides the total cost of purchases by the average monthly equity. See In re Allen George Dartt, 48 S.E.C. 693 (1987); Report of the Special Study of the Options Markets to the Securities and Exchange Commission, H.R. Com. Print IFC3, 96th Cong., 1st Sess. (1978).

[7] This is sometimes expressed as the "break-even cost factor." The phrases refer to identical calculations. See In re Donald A. Roche, Exchange Act Rel. No. 38742 (June 17, 1997). This calculation represents the percentage of return on the customer's average net equity needed to pay broker/dealer commissions and other expenses, such as margin interest. Put another way, because of the transaction costs related to trading, the account would need to appreciate that amount to break even. See Frederick C. Heller, supra, at 276-77.

[8] The term "in and out" trading refers to the sale of all or part of a portfolio, with the money from the sale being reinvested in other securities, followed by the sale of the newly acquired securities. See Costello v. Oppenheimer & Co., 711 F.2d 1361, 1369 n.9 (7th Cir. 1983).

[9] In re Donald A. Roche, Exchange Act Rel. No. 38742 (June 17, 1997) (turnover rates of 3.3, 4.6 and 7.2 provided strong support for finding of churning); Gerald E. Donnelly, supra, at 4 n.11 (noting that respondent acknowledged that "an annualized turnover rate of between two and four percent is presumptive of churning."); Michael H. Hume, supra, at 4 n.5 (noting that turnover rates of 3.5 and 4.4 were found to be excessive in past cases); John M. Reynolds, supra, at 808 n.12 (1992) (finding excessive trading, in part, based on the fact that the account was turned over more than four times on an annualized basis); In re R.H. Johnson & Co., 36 S.E.C. 467, 469-80 (1955) (turnovers of 3.26 to 11.1 annually found to be excessive).

account is greater than six.[10] Excessive trading has also been found in cases in which the cost-equity ratio was between 15 and 30 percent, or more.[11] With regard to evidence of "in and out" trading, the Seventh Circuit Court of Appeals has remarked that, "it is a practice extremely difficult for a broker to justify." Costello, 711 F.2d at 1369 n.9.

If the two elements discussed above are present, then excessive trading is established. There is no scienter requirement under the NASD rules related to excessive trading. See Erdos v. SEC, 742 F.2d 507, 508 (9th Cir. 1984); Frederick C. Heller, supra, at 280.

Excessive trading in an account, however, not only implicates Conduct Rules 2110, 2120 and 2510, but also may be viewed as quantitative unsuitability, violative of Conduct Rules 2310 and 2860(b)(19). As the SEC has recognized, "[d]epending on a particular customer's situation and account objectives, the extent of trading alone may render transactions unsuitable. Hence, excessive trading represents an unsuitable frequency of trading and violates NASD suitability standards." In re Paul C. Kettler, 51 S.E.C. 30, 32 (1992); see also In re Michael H. Hume, Exchange Act Rel. No. 35608, at 4 n.5 (April 17, 1995); John M. Reynolds, supra, at 806.[12] A suitability violation, of course, may also be premised on the quality of the transactions. In either case, a representative may make only such recommendations -- or effect such transactions in cases where the representative controls the account --

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[10] See, e.g., In re Peter C. Bucchieri, Exchange Act Rel. No. 37218, at 7 (May 14, 1996) ("While there is no clear line of demarcation, courts and commentators have suggested that an annual turnover rate of six reflects excessive trading.") (citing Mihara v. Dean Witter & Co., 619 F.2d 814, 821 (9th Cir. 1980)); In re Shearson Lehman Hutton Inc., 49 S.E.C. 1119, 1122 (1989) (same).

[11] See, e.g., Peter C. Bucchieri, supra, at 2-7 (finding that cost-equity ratio for accounts of 22.4 percent, 25.6 percent, 21.8 percent, and 24.9 percent supported finding of excessive trading); In re Thomas F. Bandyk, Exchange Act Rel. No. 35415 (Feb. 24, 1995) ("His excessive trading yielded an annualized commission to equity ratio ranging between 12.1% and 18.0%."); Frederick C. Heller, supra, at 277 (cost-equity ratio of 36 percent evidenced excessive trading); In re Michael David Sweeney, 50 S.E.C. 761, 763-65 (1991) (cost-equity ratios of 27 percent, 44 percent, 36 percent, and 22 percent indicated excessive trading).

[12] The NASD Board of Governors' policy statement with respect to fair dealing with customers, which appears in the NASD Manual following the suitability rule, provides in pertinent part as follows: "Some practices that have resulted in disciplinary action and that clearly violate this responsibility for fair dealing are . . . [e]xcessive activity in a customer's account. . . ." IM-2310-2.

as would be consistent with the customer's financial situation and needs. See In re Larry Ira Klein, Exchange Act Rel. No. 37835, at 10 (Oct. 17, 1996). Even where 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. See John M. Reynolds, supra, at 809 (regardless of whether the customers wanted to engage in aggressive and speculative trading, the representative was obligated to abstain from making recommendations that were inconsistent with their financial situation); In re Gordon Scott Venters, 51 S.E.C. 292, 294-95 (1993) (same).

Finally, a cause of action for misappropriation of customer funds, as was alleged here, may be brought under Rules 2110 and/or 2330. Misappropriation or improper use of customer funds has been found to exist in cases in which a representative used customer funds to pay personal expenses or to bankroll his friends,[13] a representative transferred funds from one customer's account to another's without authorization,[14] or a representative accepted funds for a transaction, did not timely make the purchase, and failed to return the funds promptly.[15]

With these general principles in mind, we turn to the pertinent facts in this case. Each customer account will be discussed separately below.

Customer W's Account. The DBCC found that Pinchas had engaged in excessive trading in customer W's account. As a part of this conclusion, the DBCC determined that Pinchas had controlled customer W's account, primarily because she did not have the ability to understand the activities undertaken. The DBCC also found that the transactions in the account were excessive.

Pinchas argues that he did not control customer W's account. In support, he maintains that she had the ability to read and write in English and understand American Sign Language. He states that she was intelligent and had business sense. He also argues that customer W was an aggressive and risk-tolerant investor, who was willing to assume the risks of speculative trading in options if such trading would allow her to realize her goal of doubling her money in a short period of time

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[13] See, e.g., In re Prime Investors, Inc., Exchange Act Rel. No. 38487, at 12 (April 8, 1997); In re Mike K. Lulla, 51 S.E.C. 1036, 1037-38 (1994).

[14] See, e.g,. In re Lawrence R. Klein, Exchange Act Rel. No. 36595, at 2-4 (Dec. 14, 1995).

[15] See, e.g., In re Bernard D. Gorniak, Exchange Act Rel. No. 35996, at 3-4 (July 20, 1995); In re Joel Eugene Shaw, 51 S.E.C. 1224, 1225-26 (1994); In re Raymond M. Ramos, 49 S.E.C. 868, 869-70 (1988).

so that she could buy a house. Pinchas asserts that she authorized all of the trades at Prudential and many of the trades at Lieberbaum. Pinchas further claims that he did not engage in excessive trading in her account, although he does not dispute that he wrote the orders that resulted in the account activity described above.

Pinchas' assertions are belied by the facts. Pinchas did control customer W's account, both at Prudential and Lieberbaum. Customer W testified that she could not understand English very well, either in writing or in sign language. Her testimony on this point, moreover, was corroborated by numerous witnesses and by two independent agencies, Catholic Charities and LaGuardia Community College, both of which stated by letter that customer W could neither read nor write in English above a second grade level. Because of this language barrier, she could not reasonably have been expected to read, let alone understand, the account information that Pinchas claims he provided to her.

Even if we were to assume, arguendo, that she could understand English beyond a second grade level, the evidence supports the DBCC's finding that she lacked the investment sophistication to understand the trading that Pinchas conducted in her account. Other than receiving certain Marriott stocks through an employee stock-compensation plan, she had no experience investing in stocks, bonds or options prior to opening an account with Pinchas and she had only the equivalent of a high school education, which she received in Taiwan. Moreover, customer W gave Pinchas discretionary authority over the account at Lieberbaum.

With regard to the trading activity in customer W's account, we find that it was excessive. Pinchas effected 17 purchases and 13 sales in the account at Prudential (all of which were equity transactions) during a six-month period from December of 1989 to June of 1990, and 35 purchases and 28 sales in the account at Lieberbaum during an eight-month period from June of 1990 to February of 1991 (which included 2 equity and 33 options purchases, as well as 9 equity and 19 options sales), bringing the total number of purchases to 52 and sales to 41 between December of 1989 and February of 1991. Of the 19 equity purchases, 11 percent were held for fewer than 16 days, 42 percent were held for fewer than 31 days, and 16 percent were held for fewer than 61 days. Of the total purchases (including both equities and options),[16] 37 percent were held for fewer than 16 days, 39 percent were held for fewer than 31 days, and 12 percent were held for fewer than 61 days. The account also accumulated margin interest of $2,403.71 while at Prudential and $817.07 while at Lieberbaum, bringing the total accumulated margin interest to $3,220.78 during the period that the account was open. The account had a turnover

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[16] For purposes of calculating overall holding periods (including both equity and options transactions), 51 purchases were used, i.e., 52 total purchases less one purchase to cover a short sale.

rate of 8.31 and an annualized turnover rate of 16.63 during the six months that it was at Prudential.[17] In addition, there was a pattern of "in and out" trading.[18]

Pinchas' trading in the account was profitable to him. Pinchas received gross commissions of $8,803.84 while the account was at Prudential and $9,164.71 while it was at Lieberbaum, for a total of $17,968.55 during the period of December of 1989 to February of 1991. The antitheses was true for customer W, as she lost nearly the entire balance of her account. In fact, the annualized cost-equity ratio for the account was 80 percent while at Prudential and 165 percent while at Lieberbaum. Thus, on an annualized basis, customer W would have had to have received returns of 80 percent at Prudential and 165 percent at Lieberbaum just to break even.[19] Given these facts, which Pinchas does not dispute,[20] the account activity was clearly excessive. Accordingly, we find that Pinchas engaged in excessive trading in violation of Conduct Rules 2110 and 2510.[21] In light of the conduct described

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[17] As mentioned above, there were no options transactions while the account was at Prudential. Turnover ratios were not calculated for the account at Lieberbaum because of the large number of options transactions.

[18] For example, FNMA warrants were bought and sold four times. Home Shopping Network securities were also bought, sold and then repurchased.

[19] Similarly, the annualized commission-equity ratio for the account was 63 percent while at Prudential and 151 percent while at Lieberbaum. As a result, on an annualized basis, customer W would have had to have received returns of 63 percent at Prudential and 151 percent at Lieberbaum simply to pay for the gross commissions.

[20] See Tr. at 1839 and 1842. The documentary evidence relied on for the determinations made herein regarding customer W may be found at Complainant's Exhibits 2, 4 through 23, 31, 32, 42, and 43.

[21] Because we find that the equity trading alone was excessive, and because the options transactions Pinchas recommended were unsuitable (discussed infra), we do not reach the issue of whether the options trading was excessive. Nonetheless, we note that excessive options trading is actionable, although a slightly different analysis than that used in the equity setting is normally applied. See Report of the Special Study of the Options Markets to the Securities and Exchange Commossion, H.R. Com. Print IFC3, 96th Cong., 1st Sess. (1978) (recommending the use of a modified Looper formula to calculate turnover ratio and emphasizing the significance of evidence relating to commission-equity and/or cost-equity ratios in excessive options trading cases). See also Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 767 F.2d 1498 (11th Cir. 1985) (upholding jury award of damages for excessive options trading in private-party action); In re Bradford John

above, we further find that Pinchas acted in his own self-interest and with reckless disregard for customer W's interests in violation of Rule 2120. See, e.g., Mihara, 619 F.2d at 821 (noting that scienter may be established by showing that the representative acted with the intent to defraud or with reckless disregard for the customer's interests); In re Michael Alan Leeds, 51 S.E.C. 500, 506 (1993) (same).

The DBCC also found that the recommended and effected transactions were unsuitable for customer W. We agree. According to the new account form that customer W signed at Prudential, her objective for opening the account was long-term growth. The account form at Lieberbaum indicated that her investment objective was growth. In addition, she had an income of only approximately $15,000 per year as a hotel attendant, which was the primary means of support for her family. She was also unsophisticated in securities transactions and had difficulty reading and understanding English. The aggressive and speculative trading in her account -- which, as discussed above, included buying and selling warrants and options and trading on margin -- was unsuitable.

Pinchas argues that the trades were a result of customer W's insistence that she be able to double her investment so that she could purchase a house. As an initial matter, Pinchas' trading strategy certainly was not likely to and in fact did not result in a doubling of her investment. Pinchas' claim, moreover, is both self-serving and completely contradicted by the evidence. Perhaps more significant is that, even if true, it would not provide him with any defense. A representative is obligated to recommend and effect only those trades that are suitable based on the customer's situation. This Pinchas obviously did not do. We, therefore, uphold the DBCC's finding that Pinchas recommended and effected unsuitable transactions, in violation of Conduct Rules 2110, 2310, 2510 and 2860.[22]

Titus, Exchange Act Rel. No. 38029 (Dec. 9, 1996) (upholding failure to supervise salesman who engaged in excessive and unsuitable options trading); In re Dan Adlai Druz, Exchange Act Rel. No. 36306 (Sept. 26, 1995) (rejecting contention that the excessive trading prohibition does not apply to options transactions); In re Frank DeRose, 51 S.E.C. 652 (1993) (affirming NYSE's finding of violation for excessive options trades in customer accounts); In re Paul C. Kettler, 51 S.E.C. 30 (1992) (discussing failure to supervise a salesman who engaged in excessive and unsuitable options trading).

[22] See, e.g., In re Patrick G. Keel, 51 S.E.C. 282, 284 (1993) (upholding imposition of a bar for a suitability violation and reiterating that, "before a registered representative recommends risky or speculative investments (such as options), 'he must be satisfied that they are appropriate for the particular customer. He must also be satisfied that the customer fully understands the risks involved and is not only able but willing to take those risks.'") (citations omitted); In re Clyde J. Bruff, 50 S.E.C. 1266, 1269 (1992) ("Even if the Pattersons wished to engage in aggressive and

Finally, the DBCC found that Pinchas made improper use of the funds in customer W's account. Specifically, this cause of action related to the transfer of $6,000 from customer W's account to an account held in the name of Pinchas' cousin and controlled by Pinchas.

Pinchas provided two contradictory explanations of the transfer of the $6,000. Under his first version ("Version 1"), customer W had agreed to pay Pinchas $6,000 in return for services that Pinchas provided to her and her family with regard to their becoming United States citizens, including helping them to fill out immigration applications and tutoring them in American history. According to Pinchas, he believed that he could not receive this payment directly from customer W and, therefore, he and customer W had agreed that payment would be made by transferring the money to his cousin's account, which he managed.

Pinchas subsequently disavowed Version 1 in favor of a second explanation ("Version 2"). Under Version 2, Pinchas claims that customer W, Pinchas' cousin, and a third party secretly agreed to transfer $6,000 from customer W's account to Pinchas' cousin's account so that customer W could invest in options. (Her account at Prudential was not approved for options trading.) Pinchas asserts that the conspirators kept this transfer a secret from him until a week after it had occurred.

The DBCC stated that it was unable to make a definitive finding as to exactly what had happened with respect to the $6,000 transfer, but that Pinchas either knew, or should have known, about the transfer and that, under either version, his conduct was improper. We do not disagree with the DBCC's conclusion that under either version Pinchas engaged in misconduct. We do, however, differ somewhat from the DBCC's holding in that we find, after reviewing the entire record in this case, that Pinchas purposefully and without customer W's knowledge or consent misappropriated the $6,000.

Customer W testified that she did not know Pinchas' cousin, did not agree to transfer $6,000 out of her account, and did not know about the transfer until the NASD brought it to her attention in 1992. Customer W's testimony in this regard is supported by another witness. Customer W also denied knowing Pinchas' cousin or authorizing the transfer in her responses to the March 1993 written questions from

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speculative options trading, Bruff was obligated [under the NYSE's rules] to counsel them in a manner consistent with their financial situation."); In re Arthur Joseph Lewis, 50 S.E.C. 747, 748 (1991) (affirming finding of unsuitability and noting that salesmen must adhere to stricter requirements regarding recommendations involving options transactions).

the staff. To the extent that there was any inconsistency in Customer W's testimony, we do not find it to be germane to the present issue.

In contrast, we find Pinchas' version of the events to be unbelievable. In Version 1, Pinchas arranged the transfer which he viewed as payment for his services related to assisting customer W with certain immigration and citizenship issues. This version was originally offered by Pinchas during his on-the-record interview with the NASD in April of 1992. He then again offered this version in a chronology that he prepared as an attachment to his answer to the complaint, dated May 25, 1993, and incorporated by reference in his answer to the amended complaint, dated March 31, 1995. Moreover, an attorney who previously acted as Pinchas' counsel, with full and knowing waiver by Pinchas of the attorney-client privilege, acknowledged that Pinchas had represented to him that Pinchas had both arranged for the transfer of funds and received the money.

Pinchas offered Version 2 at the DBCC hearing. As previously mentioned, under Version 2, Pinchas claims that his cousin and customer W secretly conspired to transfer the money so that customer W could trade options. Pinchas' explanation for the earlier, different and contradictory version of events was that the stenographer or interpreter at the on-the-record interview in April of 1992 had misinterpreted his testimony and that his attorney (who no longer represents him) had created the chronology. At the DBCC hearing, Pinchas introduced a "corrected" transcript of his April 1992 on-the-record interview. His "corrections," however, made wholesale changes to his previous testimony that could not plausibly be blamed on stenographer or interpreter error. In making these changes, Pinchas apparently sought to make his April 1992 testimony and the chronology consistent with his subsequent testimony at the DBCC hearing. Furthermore, it seems unlikely that customer W and Pinchas' cousin somehow entered into a conspiracy so that customer W could trade options in light of the language barrier that existed between them[23] and the fact that neither was versed in options trading.

The ever-changing and contradictory nature of Pinchas' explanation for the transfer of the $6,000 leads us to reject his versions of the event. See, e.g., In re James M. Russen, 51 S.E.C. 675, 679 n.16 (1993) ("The evolving nature of Russen's various and inconsistent defenses causes us to reject this latest account of events, as well."). We find that Pinchas violated Conduct Rules 2110 and 2330, as alleged in cause three of the amended complaint, by misappropriating or causing to be misappropriated the $6,000 that was transferred from customer W's account to the account of Pinchas' cousin.

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[23] Customer W primarily reads and writes in Chinese. Pinchas' cousin mainly reads and writes in Russian, Bukharian and Hebrew and does not know any sign language.

Customer S' Account. The DBCC found that Pinchas controlled customer S' account and that he effected excessive trades in the account. We find that there is ample support in the record to sustain this holding.[24] Customer S' on-the-record testimony in June of 1993 indicated that Pinchas normally effected trades without her knowledge and that she did not have a good understanding of the stock market in any event. Customer S' former broker also testified that customer S did not have the ability to grasp even the most basic investment concepts. Moreover, the account at Lieberbaum was discretionary. Consistent with this and other evidence,[25] we find that Pinchas controlled the account.

As to the trading activity, we note that Pinchas effected 59 purchases (all equity transactions) and 80 sales (all but two of which were equity transactions) in the account at Prudential during an 11-month period from July of 1989 to June of 1990, and 72 purchases and 61 sales in the account at Lieberbaum during a 14-month period from June of 1990 to August of 1991 (including 26 equity and 46 options purchases, as well as 35 equity and 26 options sales), bringing the total number of purchases to 131 and sales to 141 in the account from July of 1989 to August of 1991. The accounts at both firms were characterized by short holding periods. Of 81 equity purchases sold during the life of the account,[26] 36 percent were held for fewer than 16 days, 17 percent were held for fewer than 31 days, and 21 percent were held for fewer than 61 days. Of the 124 total purchases that were sold during the 25 months that the account was open (including both equity and options transactions),[27]

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[24] Although customer S did not testify at the DBCC hearing, there is substantial documentary evidence to support such a finding. We note, as well, that the SEC has emphasized in past cases that "testimony from the customer is not indispensable to [a finding of excessive trading] if the relevant information can be gleaned from other sources in the record." In re Michael David Sweeney, 50 S.E.C. 761, 767 (1991). See also In re Bernard D. Gorniak, Exchange Act Rel. No. 35996, at 3 n.5 (July 20, 1995) ("The NASD's power to enforce its rules is independent of a customer's decision not to complain, which may be influenced by many factors."); In re Ronald J. Gogul, Exchange Act Rel. No. 35824, at 8 n.20 (June 8, 1995) (finding the lack of any customer complaints to be irrelevant); In re Joseph H. O'Brien, 51 S.E.C. 1112, 1115 (1994) (finding "immaterial" a late-filed letter from a customer seeking "unconditionally" to withdraw her complaint against respondent).

[25] For instance, there is evidence indicating that customer S read at a fourth grade level and had math skills at a sixth grade level.

[26] There were only 81 equity purchases that were sold during the life of the account.

[27] This figure was arrived at by taking the 131 total purchases less five

40 percent were held for fewer than 16 days, 27 percent were held for fewer than 31 days, and 16 percent were held for fewer than 61 days. The accounts also accumulated margin interest of $5,435.35 at Prudential and $5,860.46 at Lieberbaum, totaling $11,295.81 over the life of the account. The account had a turnover rate of 19.29 and an annualized turnover rate of 21.04 in the 11 months that it was open at Prudential.[28] In addition, there was a pattern of "in and out" trading.[29]

As with customer W's account, Pinchas' trading in customer S' account was profitable to him. Pinchas received gross commissions of $44,359.98 while the account was at Prudential and $32,002.53 while the account was at Lieberbaum, totaling $76,362.51 during the period of July of 1989 to August 1991. Customer S did not fare so well, suffering losses approaching $200,000. Moreover, the annualized cost-equity ratio for the account was 67 percent while at Prudential and 53 percent while at Lieberbaum.[30] In light of these facts, which Pinchas does not contest,[31] we find that Pinchas engaged in excessive trading in violation of Conduct Rules 2110 and 2510.[32] Given the flagrant nature of the inappropriate trading activity, we also find that Pinchas acted in his own self-interest and with reckless disregard for customer S' interests in violation of Rule 2120. See Mihara, supra, at 821; Michael Alan Leeds, supra, at 506.

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purchases not sold and two purchases to cover short sales.

[28] There were no turnover ratios calculated for the account while it was at Lieberbaum.

[29] Boeing was transferred from Merrill Lynch, sold and then repurchased within 15 days. Similarly, Summit Technology was bought and sold three times in a six-month period. Other stocks that were bought and sold multiple times included Compaq, FNMA Warrants, MCI, Microsoft, Motorola, UAL Corp. and Upjohn.

[30] The annualized commission-equity ratio for the account was 60 percent while at Prudential and 44 percent while at Lieberbaum.

[31] See Tr. at 1839, 1842. The documentary evidence relied on for the determinations made herein regarding customer S may be found at Complainant's Exhibits 2, 24 through 36, 44, and 47.

[32] As with customer W's account, because we find that the equity trading in customer S' account by itself was excessive, and because the options transactions were unsuitable (as discussed below), we do not reach the issue of whether the options trading was excessive.

The DBCC held that there was insufficient evidence of customer S' lack of financial sophistication and understanding to sustain a finding of unsuitability. We disagree with this holding. We find that there is substantial evidence to support a violation of the suitability rules. First, as mentioned above, both the NASD and the SEC have held that excessive trading itself represents unsuitable account activity and violates the NASD suitability standards. Here the account activity was patently excessive. Second, we find that the evidence does indicate that customer S was unsophisticated with regard to securities investments. She had little formal education and had previously only invested in conservative stocks, a far cry from the extremely speculative and complicated world of options, warrants and margin debt that she entered when Pinchas took over her account. Third, the trading activity was inconsistent with her financial needs. Customer S did not work and derived a large portion of her income from her securities account. The high turnover and short-term strategies that Pinchas used, not to mention the speculative nature of the investments, were inconsistent with customer S' financial situation. Accordingly, we find that Pinchas violated Conduct Rules 2110, 2310, 2510 and 2860.[33]

Procedural Arguments. Pinchas raises numerous arguments about perceived procedural improprieties or conspiracies against him by each party connected in any way to the proceeding below (including, among others, the staff, the hearing panel, and the attorney-advisor). The dubious allegations he makes, even if true, have no relevance or bearing on the instant proceeding. Moreover, his allegations are completely unsubstantiated. We find nothing in the record to indicate that there was any impropriety related to the proceedings before the DBCC. Indeed, we find that the staff, the hearing panel and the attorney-advisor went out of their way to assure a fair and orderly proceeding.[34] We thus reject Pinchas' numerous conspiracy theories. See, e.g., In Mayer A. Amsel, Exchange Act Rel. No. 37092, at 8-9 (April 10, 1996) (rejecting unsubstantiated claims of bias); In re Dan Adlai Druz, Exchange Act Rel. No. 36306 (Sept. 29, 1995) (rejecting myriad unsubstantiated accusations of impropriety involving fraud, corruption, and collusion by the hearing officer, enforcement division and firm), aff'd, 103 F.3d 112 (1996).

Pinchas also argues that the complaint should be dismissed based on a theory of laches because of a delay in the initiation of the case. The SEC has emphasized that "[a] successful laches defense requires the applicant to show both a lack of diligence by the party against whom the defense is asserted and prejudice to the

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[33] See supra note 22 and cases cited therein.

[34] In addition, the DBCC, and not the staff or the hearing panel, decided this case below. Our de novo review, moreover, cures any possible prejudice. See, e.g., In re Dillon Sec., Inc., 51 S.E.C. 142, 150 n.29 (1992); In re Jonathan Garrett Ornstein, 51 S.E.C. 135, 138 n.5 (1992).

applicant." Larry Ira Klein, supra, at 12. We find that Pinchas has failed to prove either prong of this test and, therefore, we reject his laches argument.

In addition, Pinchas requested on appeal that the NASD secure the appearance of 12 witnesses and indicated his desire to introduce additional documentary evidence. The NAC subcommittee that presided over the appeal hearing denied the request on the basis that Pinchas had not shown good cause for having failed to introduce the evidence before the DBCC and had not demonstrated that the evidence was material to these proceedings. See NASD Procedural Rules 9311 and 9312; see also Ronald J. Gogul, supra, at 8 n.18.[35] The subcommittee also explained that the NASD does not have subpoena power and cannot compel participation by non-party witnesses who are not under the jurisdiction of the NASD. After reviewing Pinchas' request, we agree with the subcommittee's evidentiary ruling and adopt it as our own.

Sanctions

Pinchas' conduct in this case was deplorable. He engaged in blatant excessive trading and made wholly unsuitable recommendations with regard to separate customer accounts over the course of a two-year period. He also misappropriated $6,000 worth of customer funds. Rather than fulfilling his duty to act in a just and equitable manner, he acted in reckless disregard of his customers' interests for his own personal gain. Moreover, he has never taken responsibility for his conduct, instead maintaining throughout this disciplinary action that he is the victim of certain unsubstantiated conspiracies. There can be no doubt that Pinchas is not fit to remain associated with the securities industry.

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[35] We note that Pinchas was nevertheless permitted to introduce some of the documentary items during the appeal hearing.

Based on the foregoing, it is ordered that Pinchas be censured, fined $219,821[36] and barred from association with any member firm in any capacity. The bar is effective immediately upon the issuance of this decision.[37]

On Behalf of the National Adjudicatory Council,

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Alden S. Adkins, Senior Vice President and General Counsel

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[36] The fine, totaling $219,821, consists of $50,000 for excessive trading of customer W's account, $9,423 in net commissions on customer W's account, $50,000 for unsuitable recommendations to customer W, $20,000 for improper use of customer W's funds, $50,000 for excessive trading of customer S's account, and $40,398 in net commissions on customer S' account. (The net commissions were calculated using a 55 percent payout rate at Prudential and a 50 percent payout rate at Lieberbaum.) Although we find that Pinchas recommended unsuitable trades with regard to customer S' account, we do not impose any additional monetary fine because we conclude that the fine rendered by the DBCC, when viewed in conjunction with the other sanctions we impose today, is sufficiently remedial. We also have not imposed any requirement that Pinchas make restitution to his customers because both customers entered into settlements with firms that recompensed them for their losses. In addition, because of the unique circumstances of this case, we do not impose on Pinchas the costs of these proceedings. Finally, in light of the bar, we eliminate the requirements that Pinchas requalify by examination and that special supervisory procedures be implemented prior to his reassociating with a member firm.

[37] We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

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

Direct: (202) 728-8332
Fax: (202) 728-8264

Alden S. Adkins
Senior Vice President
and General Counsel

July 7, 1998

VIA FIRST CLASS/CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Rafael Pinchas
Hilcrest, New York

Re: Complaint No. C10930017: Rafael Pinchas

Dear Mr. Pinchas:

Enclosed herewith is the Decision of the National Adjudicatory Council in connection with the above-referenced matter. Any fine and costs assessed should be made payable and remitted to the National Association of Securities Dealers, Inc., Department #0651, Washington, D.C. 20073-0651.

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

Your application must identify the NASD Regulation case number, and set forth in summary form a brief statement of alleged errors in the determination and supporting reasons therefor. You must include an address where you may be served and phone number where you may be reached during business hours. If your address or phone number changes, you must advise the SEC and NASD Regulation. If you are represented by an attorney, he or she must file a notice of appearance.

The address of the SEC is:
Office of the Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW, Stop 6-9
Washington, DC 20549

The address of NASD Regulation is:
Office of General Counsel
NASD Regulation, Inc.
1735 K Street, NW
Washington, DC 20006

Questions regarding the appeal process may be directed to the Office of the Secretary at the SEC. The phone number of that office is 202-942-7070.

Very truly yours,

Alden S. Adkins
Senior Vice President
and General Counsel

Enclosure

cc: Denis McCarthy, Esq.