

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

FAUSTO E. CALLAVA
(CRD No. 4139260),

Respondent.

Disciplinary Proceeding
No. E072004088501

Hearing Officer—Andrew H. Perkins

HEARING PANEL DECISION

September 11, 2006

Respondent violated NASD Conduct Rule 2110 by selling unregistered securities in violation of Section 5 of the Securities Act of 1933, falsifying documents associated with the sale of unregistered securities, and engaging in unethical conduct. For these violations, the Respondent is barred from associating with any NASD member in any capacity.

Appearances

Joel R. Beck, Atlanta, GA (Rory C. Flynn, NASD Chief Litigation Counsel, Washington, DC, and Mark P. Dauer, New Orleans, LA, Of Counsel) for the Department of Enforcement.

David R. Chase, Hollywood, FL, for Fausto E. Callava.

DECISION

I. INTRODUCTION

The Department of Enforcement (“Enforcement”) filed an Amended Complaint¹ against Fausto E. Callava (“Callava” or the “Respondent”) on March 30, 2006. The three-cause

¹ Enforcement filed the original Complaint January 5, 2006, which also charged Carlos O. Medina (“Medina”) with the same offenses. On January 30, 2006, Medina submitted an uncontested offer of settlement, which NASD accepted on February 3, 2006. Under the terms of the settlement, Medina was barred from the securities industry.

Amended Complaint charged that Callava violated NASD Conduct Rule 2110 by (1) participating in the sale of an unregistered offshore variable annuity in violation of Section 5 of the Securities Act of 1933 (“Section 5”); (2) falsifying documents related to the sale of the unregistered offshore annuity; and (3) engaging in unethical conduct.

Callava filed an Answer to the Amended Complaint on March 31, 2006, in which he admitted the charges and requested a hearing.

The hearing was held at NASD’s offices in Boca Raton, Florida on July 20, 2006. The Hearing Panel included the Hearing Officer and two current members of NASD’s District 7 Committee. Callava testified on his own behalf; Enforcement did not call any witnesses to testify. In addition, the Parties submitted Stipulations of Facts and Authenticity and Admissibility of Documents. In accordance with the Parties Stipulations, all of the Parties’ proposed exhibits were admitted into evidence.²

II. FINDINGS OF FACT

A. The Respondent

Callava is 33 years of age and a resident of Miami, Florida. He graduated with a BA degree in business administration from Florida International University in 1996. Following graduation, he worked for the Miami Dade County Administrative Office of the Courts until December 1999. In January 2000, he went to work for MassMutual Life Insurance Company where he was a salesman. Callava stayed at MassMutual for approximately two years and then joined Citicorp Investment Services Inc. (“Citicorp”) in November 2001. Callava testified that he moved to Citicorp so that he could offer his clients a wider array of investment choices.³ Citicorp terminated Callava on November 17, 2004, due to his involvement with the sale at issue in this

² The hearing transcript is cited as “Tr.,” followed by the page number. Enforcement’s exhibits are labeled with the letter “C”; the Respondent’s are labeled with the letter “R.” The Stipulations are cited as “Stip.”

³ Tr. 14-17.

disciplinary proceeding. Callava was registered as a General Securities Representative while at Citicorp.⁴

Callava testified that he grossed \$950,000 in 2002, \$1.05 million in 2003, and \$850,000 for the first 11 months of 2004.⁵ On average, Callava's payout was \$400,000 per year while he was at Citicorp.⁶

Callava has no disciplinary history.⁷

B. Sale of Unregistered Security, Falsification of Documents, and Unethical Conduct

Up until early July 2004, Callava was the only registered representative in Citicorp's branch office in Aventura, Florida. On or about July 1, 2004, Medina, a banker in Citicorp's Miami office, transferred to the Aventura office where he was to work with Callava as a registered representative. Callava did not know Medina personally, but Callava knew that Medina had been the top grossing commissioned banker at Citibank.⁸ Shortly after Medina started work at Callava's office, Callava left for a one-week vacation.⁹

On July 9, 2004, while Callava was on vacation, customer ADS, a citizen and resident of Brazil, met with Medina at the Aventura office. During their meeting, Medina sold ADS a Sunlife Financial MFS Architect Advantage variable annuity (the "MFS Annuity"). The MFS Annuity was not registered for sale in the United States, and it was not covered by an exemption from registration under Section 5 of the Securities Act. Therefore, it could not be sold to customers in the United States.

⁴ Callava was registered through Citicorp from November 5, 2001, until November 24, 2004. R-1.

⁵ Tr. 20-21.

⁶ Tr. 21.

⁷ Stip. ¶ 8.

⁸ Tr. 28-29.

⁹ Tr. 23-24.

Medina could not sign the annuity application and related documents because Citicorp had not yet assigned him a registered representative number.¹⁰ Thus, when Callava returned from vacation, Medina presented the paperwork to Callava for his signature. Callava immediately realized that Medina had violated Citicorp's policy governing the sale of offshore products by having the customer sign the annuity application while he was in the United States.¹¹ Callava discussed the situation with Medina, who also understood that the sale was improper.¹² Nonetheless, Callava signed the paperwork after Medina represented that he had done this often at the Miami branch.¹³ Although Callava had no doubt that it was wrong to proceed with the sale, he testified that he thought Medina "knew what he was doing."¹⁴ Accordingly, he signed the documents and falsely represented that ADS had signed them when he was in Brazil.

When Callava signed the documents, he knew that the application would have to be sent to the issuer from an overseas location because he had sold an offshore annuity once before.¹⁵ Accordingly, Callava and Medina devised a scheme to make it appear that Medina sold the annuity over the telephone and that ADS signed the documents in Brazil. According to Callava, he was scheduled to leave on a business trip to Venezuela in three days. Callava and Medina decided to use this as an opportunity to fax the application from Venezuela to the issuer in Bermuda, which they did.¹⁶ Medina sent the application to Callava in Venezuela, and Callava then faxed it to the issuer in Bermuda after he received an email from Citicorp that indicated that Citicorp had approved the account.¹⁷ Callava and Medina also completed other internal

¹⁰ Tr. 25-26.

¹¹ Tr. 25-26.

¹² Tr. 28-30.

¹³ Tr. 31.

¹⁴ Tr. 28.

¹⁵ Tr. 34-38.

¹⁶ Tr. 37-38.

¹⁷ Tr. 37-38.

paperwork to support their story that Medina sold the annuity over the telephone. For example, they completed and maintained a telephone log that falsely showed that ADS called Medina on July 6, 2004, to open the annuity account.¹⁸

ADS's purchase was effective on July 26, 2004.¹⁹ The commission on the sale was \$5,000, which would be paid to Callava.²⁰

When Callava returned from Venezuela, he discovered that Citicorp had not approved the annuity. It had only approved opening ADS's securities account.²¹ Accordingly, Citicorp retrieved the documents from the issuer and commenced a review of the application. From this review, Citicorp noticed that the forms had been faxed from Venezuela, not Brazil, and, in October 2004, Citicorp contacted Callava and Medina to request that they come in and explain how they sold and processed the sale of the MFS Annuity to ADS.²²

Callava and Medina then concocted a story to explain the transaction. They told Citicorp that ADS came in to the Aventura office while Callava was on vacation and spoke to Medina in general terms about offshore investments.²³ Then, according to their story, ADS returned to Brazil without signing any documents. Thereafter, Medina sent the annuity application to ADS in Brazil for his signature where they claimed he signed it.²⁴ Medina and Callava further told Citicorp that ADS had problems and could not fax the application to Bermuda. Accordingly, they had him fax the documents to Medina in Miami, and he forwarded them to Callava in Venezuela. Callava then sent the documents to the issuer in Bermuda, making it appear that ADS

¹⁸ CX-3.

¹⁹ Stip. ¶ 5; CX-5 (purchase confirmation).

²⁰ Tr. 50-51.

²¹ Tr. 39.

²² Tr. 43.

²³ Tr. 45.

²⁴ Tr. 45-46.

signed the documents overseas. Citicorp accepted their story as true and fined Callava \$500 for having violated its policies regarding the sale of offshore products.²⁵

Later, Citicorp spoke to ADS who informed Citicorp that in fact he had signed the application when he met with Medina at his office in Aventura, Florida.²⁶ On November 17, 2004, Citicorp confronted Callava with this information, at which point Callava admitted that the sale had occurred in the United States. Citicorp immediately terminated Callava's employment.

III. CONCLUSIONS OF LAW

A. Sale of Unregistered Security

Section 5 makes it unlawful to use the mails or interstate commerce to sell any security unless the security is the subject of an effective registration statement or the security or transaction is exempt from registration.²⁷ A violation of Section 5 constitutes a violation of NASD Conduct Rule 2110.²⁸

In a recent decision, the Securities and Exchange Commission ("SEC") reaffirmed the legal standards applicable to this charge. To establish a *prima facie* case of a violation of Sections 5(a) and 5(c) of the Securities Act, Enforcement must show that (1) no registration statement was in effect as to the securities; (2) the Respondents sold or offered to sell these securities; and (3) interstate transportation or communication or the mails were used in

²⁵ Tr. 49-50.

²⁶ Tr. 51-52.

²⁷ 15 U.S.C. §§ 77e(a), 77(e)(c).

²⁸ *Alvin W. Gebhart*, Exchange Act Release No. 53136, 2006 SEC LEXIS 93, at *54 n.75 (Jan. 18, 2006) ("Further, because we have consistently held that a violation of a Commission or NASD rule or regulation is inconsistent with just and equitable principles of trade, we find that the Gebharts' sale of the unregistered [securities] also constitutes a violation of NASD Conduct Rule 2110."); *Stephen J. Gluckman*, Exchange Act Release No. 41628, 1999 SEC LEXIS 1395, *165 (July 20, 1999); see *William H. Gerhauser*, 1998 SEC LEXIS 2402 (Nov. 4, 1998).

connection with the sale or offer of sale.²⁹ A showing of scienter is not required because “[t]he Securities Act of 1933 imposes strict liability on offerors and sellers of unregistered securities.”³⁰

The evidence and Callava’s admissions are sufficient to prove a *prima facie* case— Callava and Medina knowingly sold an unregistered variable annuity to customer ADS, using means or instruments of transportation or communication in interstate commerce in connection with the sale. A registration statement filed pursuant to Section 5 of the Securities Act did not cover the MFS Annuity, and Callava did not contend that it was covered by an exemption from registration.³¹ Accordingly, the Hearing Panel found that Callava violated NASD Conduct Rule 2110 by participating in the sale of an unregistered security in violation of Section 5 of the Securities Act of 1933.

B. Falsification of Documents and Unethical Conduct

NASD Conduct Rule 2110 requires members and associated persons to “observe high standards of commercial honor and just and equitable principles of trade.”³² Conduct Rule 2110 “is not limited to rules of legal conduct but rather ... it states a broad ethical principle.”³³ Disciplinary hearings under Conduct Rule 2110 are ethical proceedings; a violation of the Rule’s ethical requirements may be found where no legally cognizable wrong occurred.³⁴ NASD has

²⁹ *Gebhart*, 2006 SEC LEXIS 93, at *52.

³⁰ *Id.* at *53 n.73, quoting *Swenson v. Engelstad*, 626 F.2d 421, 424 (5th Cir. 1980).

³¹ Once Enforcement makes a *prima facie* case, the burden shifts to Respondents to prove that the transactions qualify for exemption from registration. *Gebhart*, at *53; *SEC v. Cavanagh*, 1 F. Supp. 2d 337, 361-363 (S.D.N.Y.), *aff’d*, 155 F.3d 129 (2d Cir. N.Y. 1998); *John A. Carley*, Initial Decision Release No. 292, 2005 SEC LEXIS 1745 at *87 (July 18, 2005), citing *Swenson v. Engelstad*, 626 F.2d 421, 425 (5th Cir. 1980).

³² NASD Rule 0115 extends the obligations of Conduct Rule 2110 to associated persons, as well as members.

³³ *Timothy L. Burkes*, 51 S.E.C. 356 (1993), *aff’d mem.*, *Burkes v. SEC*, 29 F.3d 630 (9th Cir. July 24, 1994). The focus of NASD rules is the “professionalization of the securities industry.” *Department of Enforcement v. Shvarts*, No. CAF980029, 2000 NASD Discip. LEXIS 6, *11 (N.A.C. June 2, 2000). To that end, NASD Conduct Rule 2110 obliges an associated person to “observe high standards of commercial honor and just and equitable principles of trade.” *District Bus. Conduct Comm. v. Roach*, No. C02960031, 1998 NASD Discip. LEXIS 11, at *16 (N.B.C.C. Jan. 20, 1998) (citations omitted).

³⁴ *Id.*

authority to impose sanctions for violations of “moral standards” even where there was no “unlawful” conduct.³⁵

Here, the evidence demonstrates—and Callava admits—that he submitted fraudulent documents to Citicorp and Sunlife Financial in connection with the sale of the MFS Annuity to ADS. Such conduct violates NASD Conduct Rule 2110.³⁶ It is also inconsistent with Conduct Rule 2110 to falsify records maintained in a member firm’s official records. As the SEC has stated, “[t]he entry of accurate information on official Firm records is a predicate to the NASD’s regulatory oversight of its members. It is critical that associated persons, as well as firms, comply with this basic requirement.”³⁷ Callava’s actions cast serious doubt upon his commitment to the standards demanded of registered persons in the securities industry. In addition, Callava lied to cover up his misconduct and thwart Citicorp’s review of the circumstances surrounding the transaction. Such conduct indicates Callava’s unwillingness or inability to comply with basic standards of moral and ethical behavior and unquestionably violates NASD Conduct Rule 2110.

IV. SANCTIONS

The NASD Sanction Guidelines (“Guidelines”) for the sale of unregistered securities provide for a fine of \$2,500 to \$50,000 and consideration of a suspension or a bar in egregious cases.³⁸ For falsification of records, the Guidelines provide for a fine of \$5,000 to \$100,000 and a bar in egregious cases.³⁹ Where sufficient mitigating factors are shown, the Guidelines provide

³⁵ See, e.g., *Benjamin Werner*, 44 S.E.C. 622 (1971).

³⁶ *Department of Enforcement, v. Prout*, No. C01990014, 2000 NASD Discip. LEXIS 18, *6 (N.A.C. Dec. 18, 2000) (“Submitting false information about customers on variable annuity applications is a violation of the NASD’s just and equitable principles of trade rule.”) (citation omitted). Cf. *District Bus. Conduct Comm. v. Peters*, No. C02960024, 1998 NASD Discip. LEXIS 42, at * 4-5 (N.A.C. Nov. 13, 1998) (holding that “forgery is conduct that is inconsistent with just and equitable principles of trade and violates the high standards of commercial honor to which the NASD holds registered individuals.... The violation is equally problematic whether the forgery is submitted to the NASD or to a member firm.”) (citation omitted).

³⁷ *Charles E. Kautz*, Exchange Act Release No. 37072, 1996 SEC LEXIS 994, at *11-12 (Apr. 5, 1996).

³⁸ NASD Sanction Guidelines at 26 (2006 ed.).

³⁹ *Id.* at 39.

for consideration of a suspension of up to two years in lieu of a bar. Enforcement recommended that the Hearing Panel bar the Respondent from associating with any member firm in any capacity because it viewed this as an egregious case. The Hearing Panel agrees with Enforcement's assessment. Callava's actions cast serious doubt upon his commitment to the standards demanded of registered persons in the securities industry.⁴⁰

The Hearing Panel began its analysis by reviewing the principle considerations applicable to each violation. As to the charge of selling an unregistered security, the Hearing Panel took into consideration that Callava knew that the sale was improper immediately upon Medina reporting the sale. Nonetheless, Callava made the calculated decision that he could get away with the sale and pocket the associated commission. This was neither a case where the Respondent "attempted to comply with an exemption from registration," or where the Respondent "sold before [the] effective date of [a] registration statement."⁴¹ With respect to the third principle, "the share volume and dollar amount of [the] transactions involved," the Hearing Panel took into consideration that the value of the MFS Annuity was relatively large (\$200,000) and that Callava stood to earn \$5,000 on the sale. A sale of this size under the facts and circumstances of this case cannot be considered a mitigating factor. Moreover, although there is no evidence of customer harm in this case, there was a significant potential for injury.

With regard to the second violation, falsification of records, the Hearing Panel took into consideration the nature of the subject records and the Respondent's deliberate fraudulent conduct. In short, the record revealed no mitigating factors whatsoever with respect to this

⁴⁰ Cf. *Department of Enforcement v. Grafenauer*, No. C8A030068, 2004 NASD Discip. LEXIS 26, at *8 (O.H.O. May 27, 2004) ("forgery is conduct that is inconsistent with just and equitable principles of trade and violates the high standards of commercial honor to which the NASD holds registered individuals. . . . The violation is equally problematic whether the forgery is submitted to the NASD or to a member firm.") quoting *District Bus. Conduct Comm. v. Peters*, No. C02960024, 1998 NASD Discip. LEXIS 42, at * 4-5 (N.A.C. Nov. 13, 1998).

⁴¹ See Principle Considerations in Determining Sanctions, Sales of Unregistered Securities, Guidelines at 26.

violation. Callava understood the gravity of his conduct, as evidenced by his efforts to conceal his actions from Citicorp when it inquired of the circumstances surrounding the sale.

The Hearing Panel also took into consideration Callava's lack of credibility and insincerity. When Callava was questioned about why he signed the annuity application knowing that it was an improper sale, he stated that he did not want to harm Medina's career. The Hearing Panel finds this explanation disingenuous. When Callava returned from his vacation and met with Medina, Callava easily could have declined Medina's request and instructed him to redo the paperwork and send it to ADS in Brazil for his signature. Had he done so, no significant discernable adverse consequences would have befallen Medina. While Medina might have been reprimanded for having taken the application from ADS in the United States, the sale could not be completed until Callava signed the application and sent it to Citicorp for its approval. Until that was done, the sale was not complete. Accordingly, the Hearing Panel finds Callava's professed concern about Medina's career to amount to nothing more than an attempt to excuse his own intentional fraudulent actions. Indeed, the Hearing Panel infers from Callava's testimony that his motive in signing the MFS Annuity documents was personal gain. Callava testified that Medina told him that he had engaged in similar transactions when he was in Citicorp's Miami branch office. And Callava knew that Medina was a top producing commissioned banker. In the Hearing Panel's view, Callava was motivated by the prospect of benefiting from Medina's sales practices rather than any concern that his career would be damaged if Callava declined to sign the MFS Annuity documents.

The Hearing Panel also noted that the address on ADS's account confirmation was in Miami, Florida, not Brazil.⁴² This evidence strongly suggests that Medina and Callava knew that ADS was not residing in Brazil at the time he purchased the annuity. Thus, Medina and Callava

⁴² CX-5.

would have known that they could not send the documents to ADS in Brazil and that he was not eligible to purchase the unregistered security.

In summary, Callava knowingly participated in a fraudulent scheme to sell an unregistered security to ADS, a foreign national. In addition, Callava concocted a series of false accounts to explain the circumstances surrounding the sale and participated with Medina in creating false and misleading documents to make it appear that Medina sold the annuity by telephone when ADS was located in Brazil. Callava engaged in this misconduct for his own financial benefit. The fact that he believed the investment to be appropriate for ADS is irrelevant. Callava knew that the sale was improper and clearly knew that it was wrong to concoct a false account of his and Medina's conduct. Under these circumstances, any sanction short of a bar would not sufficiently protect the investing public from the potential for future misconduct or act as adequate general deterrence to others in the securities industry. Accordingly, the Hearing Panel bars Callava from associating with any member firm in any capacity. In light of the bar, the Hearing Panel does not impose a fine.⁴³

V. ORDER

For the reasons set forth above, Callava is barred from associating with any member firm in any capacity for each violation of NASD Conduct Rule 2110.⁴⁴ The bars shall become

⁴³ Citicorp ultimately reversed the transaction and recovered the commission from Callava. Accordingly, Callava did not retain any financial benefit from his misconduct.

⁴⁴ The Hearing Panel has considered all of the parties' arguments. They are rejected or sustained to the extent that they are inconsistent with the views expressed herein.

effective immediately if this Hearing Panel Decision becomes NASD's final disciplinary action in this proceeding. In addition, Callava is ordered to pay costs in the amount of \$1,340.45.⁴⁵

Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

Fausto E. Callava (FedEx, next day delivery, and first-class mail)
David R. Chase, Esq. (facsimile and first-class mail)
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Mark P. Dauer, Esq. (electronic and first-class mail)

⁴⁵ The costs are composed of an administrative fee of \$750 and transcript costs of \$590.45.