

FINANCIAL INDUSTRY REGULATORY AUTHORITY

OFFICE OF HEARING OFFICERS

Department of Enforcement,

Complainant,

v.

David Michael Isabella,
(CRD No. 2515834),

Respondent.

DISCIPLINARY PROCEEDING
NO. 2006005132303

HEARING OFFICER: MAD

**ORDER ACCEPTING OFFER OF
SETTLEMENT**

Date: September 10, 2009

INTRODUCTION

Disciplinary Proceeding No. 2006005132303 was filed on March 25, 2009, by the Department of Enforcement of the Financial Industry Regulatory Authority (FINRA) (Complainant). Respondent David Michael Isabella (Isabella) submitted an Offer of Settlement (Offer) to Complainant on September 2, 2009. Pursuant to FINRA Rule 9270(e), the Complainant and the National Adjudicatory Council (NAC), a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs (ODA) have accepted the uncontested Offer. Accordingly, this Order now is issued pursuant to FINRA Rule 9270(e)(3). The findings, conclusions and sanctions set forth in this Order are those stated in the Offer as accepted by the Complainant and approved by the NAC.

Under the terms of the Offer, Respondent has consented, without admitting or denying the allegations of the Complaint, and solely for the purposes of this proceeding and any other

proceeding brought by or on behalf of FINRA, or to which FINRA is a party, to the entry of findings and violations consistent with the allegations of the Complaint, and to the imposition of the sanctions set forth below, and fully understands that this Order will become part of Respondent's permanent disciplinary record and may be considered in any future actions brought by FINRA.

BACKGROUND

1. On August 19, 1994, Isabella became registered with FINRA as a General Securities Representative through a former member firm.
2. On April 2, 2007, Isabella's registration was transferred to Morgan Stanley & Co. Incorporated (the Firm).
3. On April 9, 2008, the Firm filed a Form U5 on Isabella's behalf disclosing his discharge on April 1, 2008 for "loss of management confidence due to involvement in previously reported regulatory and litigation matters."
4. Isabella is not presently associated with a member firm.

FINDINGS AND CONCLUSIONS

It has been determined that the Offer be accepted and that findings be made as follows:

SUMMARY

5. David M. Isabella fraudulently induced customers to entrust him with their retirement savings and purchase securities from him by promising that he could achieve sustained annual rates of return of at least ten percent each and every year. He fraudulently represented to the customers, most of whom were retired or nearing retirement from Xerox Corporation (Xerox), that the returns generated as a result of his expertise would allow for a

consistent annual withdrawal rate, ranging from approximately 7% to 13.5%, from their investment portfolios, without any depletion of principal. Some customers were induced to retire early as a result of Isabella's representations. Thereafter, Isabella made unsuitable investment recommendations to the customers. Isabella's promised returns and withdrawal rates proved to be unsustainable, resulting in the depletion of the customers' retirement savings and forcing some to return to employment.

6. Isabella falsified records maintained by his employer member firm concerning the financial situation and goals of his customers. Further, in exchange for various gifts to certain Xerox employees, Isabella improperly obtained confidential employment records regarding, among other things, the retirement status of prospective customers employed by Xerox. He unethically utilized this confidential information to attract new customers. In communicating with prospective customers, Isabella used a professional designation that he did not actually possess. Finally, Isabella also provided false testimony to FINRA staff.

ISABELLA'S BUSINESS

7. From 2000 through 2003 (the relevant time period), Isabella, a former Xerox employee, solicited many of that company's retirees and potential retirees to invest with him at the Firm. Xerox was downsizing and offering retirement or early retirement packages to its employees. Virtually all of Isabella's customers were Xerox retirees whose main investment was their Xerox retirement account. Generally, the retirees had no other significant sources of income to support their living expenses and, therefore, relied on their retirement accounts to provide monthly income.

8. During the relevant time period, Isabella had over 300 customers with approximately \$50 million in assets. He opened rollover IRA accounts for over 100 of those customers.

9. Isabella invested \$20-30 million of his rollover IRA account customers' funds in Access accounts, a fee-based product in which equity trading was handled by money managers.

10. The Firm generally charged Isabella's customers a 2.5% annual fee based upon the assets held in the Access accounts.

**MISREPRESENTATIONS AND OMISSIONS
OF MATERIAL FACTS IN CONNECTION WITH SECURITIES TRANSACTIONS
(Violations of NASD Conduct Rules 2120 and 2110, IM-2310-2,
Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5
thereunder)**

11. During the relevant time period, Isabella represented to prospective customers that, if they invested their retirement money with him at the Firm, they would earn approximately 10% returns or more each year and be able to satisfy their income needs by withdrawing a consistent amount of money each year without reducing their principal. The rates of return promoted by Isabella were unrealistic, as the customers were unlikely to realize such returns each and every year during their retirement.

12. In connection with his oral sales pitch, Isabella frequently provided prospective customers with a Plan Summary, which presented rates of return of approximately 10% or more. The Summaries also indicated distribution rates of approximately 7-13.5% of the initial investment, every year for a 35-year time period.

13. These summaries showed a consistent growth of principal in the account over a 35-year period, even factoring in the scheduled annual withdrawals that would be taken from the investments.

14. On the Plan Summary, the represented annual total value of each customer's assets never fell below the amount of their principal investment. Indeed, many of these summaries represented that the customers would be multi-millionaires at the end of a 35-year period.

15. The summaries also represented that the prospective customers would earn at least 10% annual returns in perpetuity every year, failing to account for the fact that return could be less than 10% in any given year.

16. Moreover, the Plan Summaries Isabella provided to the prospective customers did not account for the additional reduction of principal resulting from the 2.5% annual Access account fee. For customers making 10% systematic withdrawals, the Access accounts would have to earn about 12.5% every year just to break even.

17. Many customers, including those identified on the Schedule of Customer Information listed on Schedule A, which is attached hereto and incorporated herein by reference, relied on Isabella's representations and summaries in determining to invest their retirement funds with him and based their decision to retire sooner than they had otherwise planned, at least in part, upon the representation that they would receive enough monthly income from their retirement accounts to live on for the rest of their lives.

18. Isabella represented to prospective customers, as demonstrated on the Plan Summary he provided to them, that they would enjoy a minimum annual return of approximately 10% to sustain their income needs without depleting their principal.

19. Isabella failed to disclose to those customers certain risks associated with his sales pitch, including:

- while a 10% average annual return was potentially achievable over the long term, customer accounts were not likely to realize a 10% return each and every year;
- if customer accounts did not achieve the 10% annual rate of return, their 10% annual withdrawals would deplete their principal; and
- adverse market conditions could significantly impact the viability of their early retirement.

20. Ultimately, many of Isabella's customers suffered erosion of their initial investment due to market declines because their monthly "income" payments were actually just distributions of their principal investment.

21. In some instances, customer retirement money was almost completely depleted within a few years. Those customers typically had no other significant source of income to subsidize their living expenses.

22. As part of this course of conduct, Isabella, in connection with the purchase or sale of securities, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, knowingly or recklessly: employed devices, schemes or artifices to defraud; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made,

in the light of the circumstances under which they were made, not misleading; engaged in acts, practices, or courses of business which operated or would operate as a fraud or deceit upon any person; or effected transactions in, or induced the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance.

**UNSUITABLE INVESTMENT RECOMMENDATIONS
(Violations of NASD Conduct Rules 2310 and 2110 and IM-2310-2)**

23. Once the Xerox employees agreed to open a retirement account at the Firm, Isabella typically employed the same approach to each of their investments without regard to individual needs or circumstances.

24. During the relevant time period, Isabella recommended and effected transactions in the accounts of the customers identified on Schedule A without having reasonable grounds for believing that such transactions were suitable for the customers in view of the over-concentration in equities, the related fees incurred, and in light of the customers' financial situation, investment objectives and needs.¹

25. Specifically, Isabella typically would initially invest approximately 60% or more of a customer's retirement funds in an equity-based Access account and the remaining funds in a brokerage account at the Firm, with fixed income securities such as bonds or bond funds.

26. Because of market losses and fees, the value of the Access accounts did not grow at the claimed rate, and so, in many cases, Isabella determined to pay for customer systematic withdrawals with funds from their brokerage account principal.

¹ Schedule A also details certain customer suitability information relevant to the violations charged in the Complaint.

27. Consequently, distributions to the customers did not derive from gains in the Access accounts, but rather from the liquidation of the investments held in each customer's fixed income account(s) at the Firm. In some instances, the distributions also came from the liquidation of assets held in the Access accounts.

28. In many cases, Isabella chose to liquidate the fixed income portion of the accounts, which had the effect of increasing the percentage of their investment portfolio allocated to equities to upwards of 85% for certain customers.

29. This undue concentration in equities caused serious harm to Isabella's customers -- their principal investment declined significantly.

30. Moreover, the decline in principal equated to a significant increase in the percentage of assets distributed to the customers to meet their living expenses.

**CREATION OF FALSE BOOKS AND RECORDS
(Violations of NASD Conduct Rules 3110 and 2110)**

31. Prospective Access account customers were supposed to complete a questionnaire about their financial circumstances, needs, risk tolerance and other critical suitability-related information.

32. Customer answers would then be entered into the database for the Access program, which was designed to consider those answers in selecting an appropriate investment manager.

33. The Access computer program would generate an "Investment Plan Summary" that would provide the names of the recommended investment managers that were suitable based

upon the customer's financial circumstances, needs, risk tolerance and other critical suitability-related information.

34. The Investment Plan Summary would then be signed by the customer, broker and branch manager to open the account and designate the selected investment manager(s).

35. During the relevant time period, however, Isabella did not follow these steps. Instead, he favored a few investment managers and routinely ensured that his customers were placed with those managers by entering the same, or similar, answers to the questionnaires – many of which were false as to those customers – directly into the Access computer program, completely forgoing the required step of actually obtaining a completed customer questionnaire. Indeed, Isabella opened a few hundred Access accounts, but only a few Access questionnaires were completed by Isabella's customers during the relevant time period.

36. Specifically, Isabella provided false information about many of the prospective customers' annual income, cash on hand, real estate holdings and whether the customer required monthly income and expected to take monthly withdrawals.

37. As a result, the customers did not receive the promised benefit of getting a manager selected based on their individual needs and financial situation.

**OBTAINING AND USING CONFIDENTIAL INFORMATION IN EXCHANGE FOR GIFTS
(Violations of NASD Conduct Rule 2110)**

38. During the relevant time period, Isabella inappropriately obtained confidential contact and employment information about Xerox employees, without their knowledge, authorization or consent, from employees in that company's Human Resources and other departments (Xerox contacts). The confidential information included hire date, telephone

number and whether the Xerox employee would be offered a retirement package. These prospective Xerox retirees were the primary targets of Isabella's marketing efforts.

39. Isabella rewarded the Xerox contacts for their assistance by providing them with gifts, such as phone cards, gift cards and/or tickets to sporting events.

**MISUSING FALSE PROFESSIONAL DESIGNATIONS ON CORRESPONDENCE WITH CUSTOMERS
(Violations of NASD Conduct Rule 2110)**

40. In connection with his solicitation of Xerox employees, Isabella often provided the customers with a Plan Summary.

41. Isabella used the professional designation of "Retirement Planning Specialist" on correspondence provided along with the Plan Summary documents. His use of this professional designation was false, however, because Isabella had not qualified for that title through a firm-administered examination.

**FALSE TESTIMONY DURING AN ON-THE-RECORD INTERVIEW
(NASD Procedural Rule 8210 and NASD Conduct Rule 2110)**

42. On July 25, 2007, FINRA staff (staff) sent a letter to Isabella at his last known residential address as reflected in the records of FINRA's Central Registration Depository: [REDACTED]
[REDACTED] (CRD - [REDACTED]). The letter requested, pursuant to NASD Procedural Rule 8210, that Isabella appear for an on-the-record interview (OTR) on October 18, 2007 at FINRA's Woodbridge District Office. Attached to the letter was an Addendum that warned Isabella that he was "obligated to provide testimony that is truthful, accurate and complete." At the request of Isabella's attorney, the OTR was rescheduled for October 24, 2007.

43. Isabella appeared for OTRs on October 24-25, 2007 and on December 5-6, 2007. He was represented by counsel, sworn in and again advised that false testimony could subject him to disciplinary action before the start of the questioning began. Isabella stated that he understood those instructions.

44. During his OTRs, Isabella testified that Access questionnaires were completed for his customers and were kept in a separate box that had been shipped to Iron Mountain to archive.

45. He further claimed that his staff communicated with Iron Mountain to obtain this box, but learned that the company had, somehow, lost it.

46. Isabella's testimony was false, in that the subject questionnaires were not sent to Iron Mountain.

47. Moreover, few of Isabella's customers completed questionnaires during the relevant time period.

Based on the foregoing, Isabella violated NASD Conduct Rules 2120, 2310, 3110 and 2110, IM-2310-2, NASD Procedural Rule 8210, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Based on these considerations, the sanction hereby imposed by the acceptance of the Offer is in the public interest, is sufficiently remedial to deter Respondent from any future misconduct, and represents a proper discharge by FINRA, of its regulatory responsibility under the Securities Exchange Act of 1934.

SANCTIONS

It is ordered that Respondent be barred from association with any FINRA member in any capacity.

The sanction imposed herein shall be effective on a date set by FINRA staff. Pursuant to FINRA Rule 8313(e), a bar or expulsion shall become effective upon approval or acceptance of this Order.

SO ORDERED.

FINRA

Signed on behalf of the Director of ODA,
by delegated authority



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