SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 39112 / September 22, 1997

Admin. Proc. File No. 3-8992

In the Matter of the Application of

GERALD JAMES STOIBER
19140 Kristine Trail
Mokena, Illinois 60448

For Review of Disciplinary Action Taken by the

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDINGS

Violation of Rules of Fair Practice

Failure to Inform Employer of Private Securities Transactions

General securities representative associated with member firm of registered securities association engaged in private securities transactions without prior written notification to member. Held, association's findings of violation and the sanctions it imposed are sustained.

APPEARANCES:

Jerome H. Ferguson, III, of Ferguson & Company, P.C., for Gerald James Stoiber.

Alden S. Adkins and Norman Sue, Jr., for NASD Regulation, Inc.

Appeal filed: April 26, 1996
Last brief received: August 1, 1996

I.

Gerald James Stoiber ("Applicant"), both a registered general securities representative and an associated person of a futures commission merchant associated with American Investment Services, Inc. ("AIS" or the "Firm"), a member of the National Association of Securities Dealers, Inc. ("NASD"), appeals from

NASD disciplinary action. The NASD found that, during the period from March 1, 1992 through at least September 23, 1993, Stoiber sold securities in the form of promissory notes to thirteen public customers without giving AIS prior written notification and receiving written approval from AIS to engage in private securities transactions, in violation of Article III, Sections 1 and 40 of the Rules of Fair Practice ("Rules"). 1/ The NASD censured Applicant, suspended him in all capacities for six months, ordered restitution to identified customers of $450,000, and fined him $450,000 to be reduced by any amounts paid in restitution within 60 days of the date of the decision. 2/ Our findings are based on an independent review of the record.

II.

Stoiber does not deny that, between March 1992 and September 1993, he borrowed a total of $495,000 from his customers. 3/ Stoiber issued promissory notes to the customers for these unsecured personal loans. 4/ The notes at issue had fixed rates

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1/ The NASD recently revised and renumbered its Rules of Practice. Section 1 of the Rules [new Rule 2110] requires the observance of "high standards of commercial honor and just and equitable principles of trade." Section 40 [new Rule 3040] provides, among other things, that, prior to participating in any securities transaction outside the regular course or scope of his or her employment, a person associated with a member firm must give that firm prior written notification. In addition, if the firm is notified that the associated person may receive selling compensation, it is required to issue written approval or disapproval.

2/ The NASD also assessed costs.

3/ The complaint alleges "[b]eginning in or about March 1, 1992 and continuing until at least on or about September 23, 1993, Respondent Stoiber offered and sold . . . securities in the form of promissory notes . . . ." We note that two of the loans were offered outside the review period, one on September 25, 1991 and another on March 1, 1991. While these two loans were outstanding during the review period, it appears that they were repaid in full prior to the NASD's District Business Conduct Committee ("District Committee") hearing. A third loan apparently was repaid in full prior to the NASD's District Committee hearing. Thus, it appears that the total balance of the loans outstanding at the time of the NASD's District Committee hearing was $450,000.

4/ Stoiber issued promissory notes as follows:

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of interest, ranging from 6% to 12% per year. According to the NASD, the interest rate on the notes was generally set at 2% above the then-current prime rate. Interest was paid in fixed installments and payment of the principal was due on or before a specific date, in most instances three years from the date of issuance. On several occasions, Stoiber refinanced and "rolled-over" notes that he issued to his customers.

Stoiber had known many of these customers for years and stated that he considered them to be friends. The customers who loaned money to Stoiber had annual incomes that ranged from $10,000 to $75,000, and net worths that varied from a low of $50,000 to a high of $1,000,000.

Stoiber admits that he asked each of these customers to loan him funds to finance commodity transactions that he could not have effected absent the loan. Stoiber informed each of the customers that the proceeds from the notes were to be used to effect commodity transactions in Stoiber's personal account at AIS, as well as for personal expenses. 5/

4/(...continued)

# of loans	amount of each loan
1	$200,000
1	$50,000
2	$40,000
1	$30,000
4	$20,000
3	$15,000
1	$10,000

We note that two of the notes in the record were not signed by Stoiber. A note for a third transaction at issue was not included in the record. Stoiber, however, admits that "[a]ll loans were spelled out by promissory notes with specific interest rates and payment dates." The record also includes signed reaffirmation letters acknowledging, among others, two of these loans. Affidavits introduced by Stoiber and executed by each customer acknowledge that "[f]or the loan, Mr. Stoiber signed and gave me a promissory note . . . ."

5/ Stoiber stated that he paid $20,000 towards the mortgage for (continued...)

Stoiber placed the funds that he received from these notes in his personal bank account, which was held jointly with his wife. The funds were generally transferred from his personal bank account to Stoiber's commodities trading account. Stoiber maintained two other bank accounts in the name of an entity that he created and named Jeffrey Investment Services ("JIS"). Interest payments on the notes were made to each customer from the JIS accounts.

Stoiber's income was derived from his commissions from AIS and any profits resulting from his commodity trading. Although each of the customers stated in an affidavit that he or she thought that Stoiber was a successful businessman, Stoiber acknowledged that, at the time of the hearing before the NASD's District Committee, he had a negative net worth of approximately $30,000. Stoiber also acknowledged that he would be insolvent if all of the customers sought repayment of their funds at once. He claimed, however, that he could obtain the funds to repay the notes, if necessary, from his parents or by liquidating family assets. 6/

III.

Article III, Section 40 prohibits an associated person of a member firm from effecting private transactions in securities without prior written notice to that person's employer. Stoiber admits that he did not give AIS written notice of the transactions at issue. Stoiber, however, contends that he did not violate Article III, Section 40 because the promissory notes at issue were not securities.

In Reves v. Ernst & Young, 494 U.S. 56 (1990), the Supreme Court considered the issue of when a note is a security within the meaning of Section 3(a)(10) of the Securities Exchange Act of 1934. The Supreme Court adopted the "family resemblance" test for determining when a note is a security. 7/ Under that test, a

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5/(...continued)
his personal residence and a portion of the funds to pay off hospital bills and credit card debt. He estimated that he used a total of $50,000 of the proceeds from the notes for personal expenses.

6/ The State of Illinois Securities Division investigated Stoiber's note transactions and ordered Stoiber to make rescission offers to each of the customers. None of the customers accepted the rescission offer. Instead, they executed a document reaffirming the notes.

7/ 494 U.S. at 64-65, 67 citing Exchange National Bank of
(continued...)

note is presumed to be a security unless (1) an examination of the note, based on four factors described by the Court, 8/ reveals that the note bears a strong resemblance to certain types of notes recognized as being outside the investment market regulated under the securities laws 9/ or, (2) based upon the same four factors, the note should be added to the list.

A. Family Resemblance to Recognized Non-Securities

The Supreme Court in Reves considered a note evidencing a character loan to a bank customer to be outside the investment market regulated under the securities laws. Applicant asserts that the notes at issue bear a strong resemblance to a note evidencing a character loan to a bank customer. 10/

7/(...continued)
Chicago v. Touche Ross & Co., 544 F.2d 1126 (2d Cir. 1976), modified by, Chemical Bank v. Arthur Andersen & Co., 726 F.2d 930 (2d Cir.), cert. denied, 469 U.S. 884 (1984).

8/ Those four factors are: (1) the motivations that would prompt a reasonable borrower and lender to enter into the transaction; (2) the plan of distributing the notes; (3) the reasonable expectations of the investing public regarding whether the instruments were securities; and (4) the presence of any alternative scheme of regulation or other factor that significantly reduces the risk of the instrument so as to make regulation under the securities laws unnecessary. 494 U.S. at 66-67.

9/ Id. at 65. The Supreme Court believed that the following notes are not securities: the note delivered in consumer financing; the note secured by a mortgage on a home; the short-term note secured by a lien on a small business or some of its assets; the note evidencing a character loan to a bank customer; a short-term note secured by an assignment of accounts receivable; the note that simply formalizes an open-account debt incurred in the ordinary course of business; and the note evidencing a loan by a commercial bank for current operations.

10/ Stoiber submitted an affidavit from an assistant vice-president and loan officer at Southwest Financial Bank of Orland Park stating that the promissory notes used by Stoiber are typical of notes which would be used by banks to make "character" or "signature" loans and that such note forms are typical of promissory notes in general. The fact that both a bank and Stoiber used the same note form does not end the analysis of whether Stoiber's note is a security. As the Supreme Court stated in Tcherepnin v.

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We do not see a family resemblance between the notes at issue and a note evidencing a character loan to a bank customer. Banks are in the business of making loans. Character loans, in particular, are generally given to longstanding, large depositors, whose credit situation is known to the financial institution. The lenders in this instance, Stoiber's customers, were not financial institutions or accustomed to assessing lending risks, nor did they make loans as part of a business.

Stoiber points to affidavits executed by each of his customers which state that the customer considered Stoiber a good businessman and a good risk. We note initially that each of these affidavits is identical and was prepared for the NASD hearing. 11/ The uniformity of the customers' understandings was not tested by cross-examination. The affidavits, moreover, are silent as to why the customer concluded that Stoiber was a good credit risk. Stoiber does not claim that customers had access to the type of financial or business information that a bank would have concerning its customer. Nor does Stoiber or any of the affiants suggest that the affiants engaged in the type of credit analysis in which a bank would engage or that Stoiber provided them with the type of information that would have made that analysis possible. 12/

10/(...continued)
Knight, 389 U.S. 332, 335 (1967)(citing SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946)), "in searching for the meaning and scope of the word 'security' in the Act, form should be disregarded for substance and the emphasis should be on economic reality."

11/ Indeed, the affidavits underscore their lack of tailoring to a particular customer. None of the affidavits discusses the customer's financial or personal situation. In addition, each states that "in the event" the affiant either made more than one loan to Stoiber or agreed to refinance a particular loan "[e]very one of the statements I am making . . . is true as to each loan and refinancing."

12/ Applicant also asserts that the notes at issue bear a family resemblance to notes evidencing loans by commercial banks for current operations. Applicant claims that the notes at issue are similar to the loan participations at issue in Banco Espanol de Credito v. Security Pacific National Bank, 973 F.2d 51 (2d Cir. 1992), cert. denied, 509 U.S. 903 (1993).

We disagree. Unlike the matter before us, the motivations of the various institutions in Banco Espanol de Credito were to promote commercial purposes. Only institutional and
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B. The Reves Factors

We further conclude that the factors described in Reves do not suggest that these notes should be excluded from regulation under the securities laws. The Supreme Court stated in Reves that an instrument is presumed to be a security, "[i]f the seller's purpose is to raise money for general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate . . . ." The Court contrasted such a note with a note used to facilitate "some other commercial or consumer purpose." 13/ Here, Stoiber issued the notes to raise funds to finance commodity transactions, as well as for his personal expenses. The customers who loaned Stoiber funds received a favorable interest rate on the notes at issue. Interest has been recognized by the Supreme Court as constituting a valuable return on an investment. 14/

Applicant, however, cites language in the customers' affidavits that states that each customer understood that he or she was making a personal loan to Stoiber and "did not intend to

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12/(...continued)
corporate entities were solicited by the bank, and the loan participations could not be resold. In addition, the Court found that the institutions, who were found to be "sophisticated purchasers," were given ample notice that the instruments were participations in loans, not investments, and that the Comptroller of the Currency issued specific policy guidelines addressing the sale of loan participations indicating that application of the securities laws was unnecessary.

Applicant also cites Smith International, Inc. v. Texas Commerce Bank, 844 F.2d 1193 (5th Cir. 1988). Smith International was decided prior to Reves and relied on a test that was superseded by Reves. Compare Reves, 494 U.S. at 63, 66-67 (describing the four factors) with Smith International, 844 F.2d at 1201 (distinguishing an earlier holding that a note was a security based on "the investment nature of the transaction giving rise to the preexisting debt which the notes represented").

13/ 494 U.S. at 66.

14/ The Supreme Court in Reves stated that profit in the context of a note means "a valuable return on an investment, which undoubtedly includes interest." Id. at 68 n.4. See also Pollack v. Laidlaw Holdings, Inc., 27 F.3d 808, 812 (2d Cir. 1994) (fixed rate of return in the form of interest does not rebut the presumption that the notes are securities).

make an investment." The affidavits do not explain this assertion further, except to state that the customers did not believe that the notes were "the same as a share of stock or a publicly offered debt instrument." This statement is not inconsistent with these documents being a private offering of a security. In any event, we believe that the "motivations that would prompt a reasonable seller and buyer to enter into" these transactions strongly suggest that they are securities. 15/ As discussed above, the customers, who were not in the business of making loans, looked to Stoiber for investment advice. Each customer affidavit states that the customer expected a "valuable return" from the notes, i.e., the customer was "to receive back my principal, plus interest as provided in the note." 16/ Stoiber admits that he solicited funds "to finance substantial investments," his commodity transactions, as well as his personal expenses. 17/

We believe the other prongs of Reves are also satisfied. The customers here varied widely as to income and net worth. There is no showing that they were sophisticated or that they asked for information that would permit them to assess Stoiber's financial condition. In most instances, they were in their sixties. It appears, moreover, that Stoiber made the same general representations to each of the customers, and there is no suggestion that any of the customers negotiated individual terms. The sole significant common denominator among the customers is that each of the customers previously had dealt with Stoiber and AIS for investment purposes. Stoiber, their registered representative, offered favorable interest rates to these customers in exchange for funds to permit him to participate in commodities trading, funds that the customers could have placed in other investments. 18/

Applicant asserts that thirteen notes are an insufficient number to be considered an offering to the general public.

15/ 494 U.S. at 66.

16/ The affidavits also state that the customers understood that they would not participate in any profits or income generated by Stoiber, were not getting an interest in stock or any other asset, and were not participating in any form of common enterprise. These factors go to whether, under SEC v. W.J. Howey Co., 328 U.S. 293 (1946), an instrument is an investment contract. The Supreme Court in Reves rejected application of the Howey test to notes. 494 U.S. at 64.

17/ Id. at 66.

18/ Stoiber admitted he has a fiduciary responsibility to these customers.

Citing the 1,600 notes issued in Reves, Applicant argues that thirteen is, as a matter of law, insufficient to constitute a public distribution. Applicant is mistaken. The number of notes is not the sole controlling factor in determining whether there has been a public distribution. Rather, the focus of inquiry should be on the need of the offerees for the protections afforded by the federal securities laws. 19/

Applicant further asserts that the customers were his friends, not members of the general public and that he did not generally advertise the notes' availability. It is not unusual, however, for investors to have a social relationship with a registered representative. The existence of a social relationship does not mean, however, that such an investor would not be entitled to the same protections that a stranger to the offeror would receive in an offering under the federal securities laws.

We are also unaware of any risk-reducing factors that would make application of the federal securities laws

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19/ See generally SEC v. Ralston Purina Co., 346 U.S. 119 (1953) (registration requirements apply to a "public offering" whether to a few or many.) See also Deal v. Asset Management Group, Fed. Sec. L. Rep. (CCH) ¶ 97,244 (N.D. Ill. 1992)(offering to six investors considered sufficient to constitute a broad segment of the public and survive defendant's motion to dismiss).

Applicant also claims that the notes at issue fail the second Reves factor because of the absence of what the Reves Court described as "common trading for speculation or investment." 494 U.S. at 66, citing SEC v. C.M. Joiner Leasing Co., 320 U.S. 344, 353 (1943). Prochaska & Associates v. Merrill Lynch, 798 F. Supp. 1427 (D. Neb. 1992), on which Applicant relies, however, involved short-term promissory notes secured by a lien on a small business that were issued to a single plaintiff. In contrast, here there was no individual negotiation of the terms, nor ability to assess Stoiber's credit worthiness by any of the thirteen customers.

unnecessary. 20/ Applicant contends that state law provides sufficient protection, but he does not cite a particular statute or provision of state law, other than to make a vague reference to remedies such as "debtor/creditor laws." Applicant also does not explain the protection state law provides, nor does he argue that state law is as protective as the federal securities laws. In this instance, it would be reasonable for investors to expect that the protection of the federal securities laws applied.

Based on our consideration of the factors cited in Reves, Stoiber has not presented sufficient evidence to rebut the presumption that the notes at issue are securities. 21/ We accordingly sustain the NASD's findings that Stoiber violated Article III, Sections 1 and 40 of the Rules. 22/

20/ Applicant cites the following cases in support of the assertion that state law can provide a sufficient remedy: Heine v. Colton, 786 F. Supp. 360 (S.D.N.Y. 1992), later opinion 856 F. Supp. 191 (S.D.N.Y. 1994); Reeder v. Succession of Palmer, 736 F. Supp. 128 (E.D. La. 1990), aff'd. mem., 917 F.2d 560 (5th Cir. 1990); and Singer v. Livoti, 741 F. Supp. 1040 (S.D.N.Y. 1990). But cf. Grady A. Deal v. Asset Management Group, Fed. Sec. L. Rep. (CCH) ¶ 97,244 (N.D. Ill. 1992); Pollack v. Laidlaw Holdings, Inc., 27 F.3d 808 (2d Cir. 1994), cert. denied, 513 U.S. 963, 115 S.Ct. 425 (1994).

We note that the cases on which Reves relied in discussing this factor, 494 U.S. at 69, involved alternative schemes of federal regulation. See Marine Bank v. Weaver, 455 U.S. 551, 558 (1982) (federal regulation of banks and FDIC insurance); International Brotherhood of Teamsters v. Daniel, 439 U.S. 551, 569-70 (1979) (ERISA). Applicant does not cite a particular provision of state law and has not demonstrated whether state law can be the source of such alternative protection.

21/ See also William Louis Morgan, 51 S.E.C. 622, 627 (1993); William F. Wuerch, 50 S.E.C. 811, 812 n.2 (1991). See also Darrell Jay Williams, 50 S.E.C. 1070, 1071-72 (1992).

22/ Applicant claims that the NASD is attempting to regulate registered representatives' activity concerning borrowing funds from customers, without having a rule that expressly governs this conduct. Applicant also asserts that, because the NASD issued Notice To Members 94-93 in December 1994, proposing a rule governing registered representatives lending to or borrowing from customers, it indicates the practice was not covered by prior NASD Rules.

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IV.

Stoiber argues that the sanctions assessed by the NASD are excessive, oppressive, and a burden on interstate commerce. He also claims that the sanctions violate the NASD's 1993 Sanction Guidelines. Stoiber notes that he has been a registered representative for almost two decades and does not have any prior disciplinary history. 23/

We are unable to conclude that the sanctions imposed by the NASD are excessive or oppressive. While the NASD's Guidelines are exactly that, guidelines, the sanctions that are assessed in this case clearly fall within the NASD's recommended sanctions for private securities transactions. 24/

Stoiber's violations involve serious conduct. Stoiber's failure to inform his Firm in writing of these securities

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22/(...continued)
Applicant is incorrect. As discussed above, we have found that the notes at issue are securities. Stoiber had a duty under Article III, Section 40 to advise his Firm of these securities transactions in writing. Stoiber's violation of Article III, Section 40 also constitutes a violation of Article III, Section 1. Steven Theys, 51 S.E.C. 473, 480 (1993). For the same reason, Stoiber's reliance on Robert J. Jautz, 48 S.E.C. 702, 704 (1987) is inapposite. There, we held that failure to repay a loan from a customer is not inconsistent with just and equitable principles of trade, absent bad faith or unethical conduct. Here, the gravamen of the violation is not the failure to receive or repay a loan but the failure to give prior written notice of the transaction to AIS. Compare Robert J. Jautz, id. with Terry Wayne White, 50 S.E.C. 211, 214 (1990)(registered representative took unfair advantage of elderly customer for personal gain by borrowing money from customer who wanted safe investments).

23/ Stoiber also asserts that the NASD did not give any weight to the fact that he spoke with his compliance director about these notes prior to their issuance. We note that Stoiber spoke generically about obtaining loans, but did not give written notification before each transaction. We have considered all the facts, including his conversation with the compliance director, in evaluating the sanctions.

24/ Stoiber wrongly asserts that he will necessarily be liable for combined fines and restitution totaling $900,000. The NASD fine of $450,000 was to be offset by any amount paid in restitution within 60 days. Therefore, if Stoiber pays that restitution in a timely manner there will be no fine.

transactions and obtain approval could be potentially harmful. Public investors were deprived of the protection to which they are entitled to expect, and his employer was exposed to risks to which it should not be exposed. 25/ Under all the circumstances, we are unable to conclude that the sanctions imposed by the NASD are excessive or oppressive.

An appropriate order will issue. 26/

By the Commission (Chairman LEVITT and Commissioners WALLMAN and JOHNSON); Commissioner HUNT dissenting.

Jonathan G. Katz
Secretary

Commissioner HUNT, dissenting:

I am unable to determine on this record whether or not the instruments in question are securities, and therefore I dissent from the majority's opinion.

25/ See generally Anthony J. Amato, 45 S.E.C. 282, 285 (1973).

26/ All contentions have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
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For Review of Disciplinary Action Taken by the

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

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

ORDERED that the disciplinary action taken by the National Association of Securities Dealers, Inc. against Gerald James Stoiber, and the Association's assessment of costs, be, and they hereby are, sustained.

By the Commission.

Jonathan G. Katz
Secretary