

PLEASE NOTE THE LATER CASE HISTORY OF THIS DECISION FOLLOWING THE TEXT OF THE DECISION.

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of
the Association

of

X

as a

General Securities Representative

with

The Sponsoring Firm

Redacted Decision

Notice Pursuant to
Section 19h-1
Securities Exchange Act
of 1934

Decision No. SD99009

On July 7, 1998, a member firm ("the Sponsoring Firm") submitted an MC-400 application ("Application") to permit X¹, a person subject to a statutory disqualification, to associate with the Firm as a general securities representative. In January 1999, a subcommittee of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by his proposed supervisor ("Proposed Supervisor"), the Vice President and Director of Sales, and the Vice President/Compliance. DB and BA appeared on behalf of the Department of Member Regulation ("Member Regulation").

X. X is subject to a statutory disqualification as a result of his 1991 nolo contendere plea to a charge of access forgery, in connection with his unauthorized use of a credit card. X was 24 years old at the time. The conduct at issue involved the unauthorized use of a credit card in the amount of \$433.18 in which, X contended, he engaged during college at the urging of several fraternity brothers. For this misconduct, X was sentenced to one year of probation, fined \$100 plus a \$170 penalty assessment, and ordered to complete 10 days of community service. In 1993, having successfully completed the conditions of his probation, X petitioned for "Record Clearance," pursuant to a Section of the state's Penal Code, pursuant to which X would withdraw his plea of nolo contendere and enter a

¹ The names of the Statutorily Disqualified individual, the Sponsoring Firm, the Proposed Supervisor, and other information deemed reasonably necessary to maintain confidentiality have been redacted.

plea of not guilty and the court would dismiss the action. X's petition was granted later in 1993.

In November 1994, member Firm A, a subsidiary of Firm B, employed X as a non-licensed sales assistant. In the same month, X submitted a Form U-4 to the Association on which he failed to disclose the 1991 charge in response to Question 22B (disclosure of being charged with certain crimes).

At that time, Association policy did not require X to disclose the conviction in response to Question 22A (disclosure of certain convictions), since he had obtained a Record Clearance under State law.²

In July 1995, X became a registered representative. In August 1995, Firm A received a Department of Justice Report that disclosed the 1991 charge. In May 1996, Firm A received an advisory from the Association indicating that X should report the 1991 charge on his Form U-4. In June 1996, X's Form U-4 was amended to reflect a "yes" answer to Question 22B.

Firm B was purchased in July 1995 by Firm C, which had a broker/dealer subsidiary, Firm D. During 1997 and early 1998, X worked in a branch office of the Sponsoring Firm. In July 1997, Firm C merged Firm A and Firm D, with Firm D being the successor firm. Firm C changed the name of Firm D to that of the Sponsoring Firm. In July 1997, Firm C purchased Firm E, which also had a broker/dealer subsidiary, Firm F.

In March 1998, X was one of a number of the Sponsoring Firm's registered representatives who attempted to transfer their registrations to Firm F. Based on a change in the Form U-4 disclosure policy in 1997, the Association notified X that his 1991 conviction was a reportable event that constituted a statutory disqualification, and that he was required to disclose both the charge and the conviction on his Form U-4. The NASD received X's Form U-4, which disclosed the 1991 charge and conviction, in March 1998.

X contends that he initially answered "No" to Question 22B on advice of counsel. He states that he sought affirmance of this advice from either the NASD, the Securities and Exchange Commission, or the Federal Bureau of Investigation, but that he kept no record of his inquiry. In correspondence to the Association, X's lawyer stated that he had advised X, "as a result of obtaining a 'record clearance' for his misdemeanor, unless there was a specific request to disclose 'cleared matters,' that he did not need to disclose same on any application."

Aside from the 1991 conviction, X has no other disclosable events and no prior disciplinary history with the Association. In 1998, he was promoted to "independent financial consultant." Further, the Association has no open investigations involving X, and he has not been the subject of any customer complaints while employed by the Sponsoring Firm.

² In late 1997, the Office of General Counsel changed its interpretation in response to advice from the Securities and Exchange Commission. Accordingly, the NASD considers a conviction expunged under this section of the state law to be a statutorily disqualifying event.

The Sponsoring Firm. The Sponsoring Firm services clients of Firm C. The Sponsoring Firm conducts a general securities business. It employs 507 registered representatives and 81 general securities principals and operates 426 branch offices. According to information provided by the Sponsoring Firm, a location has not yet been selected for X; however, the Sponsoring Firm anticipated that X would be located in one of its branch offices.

The Sponsoring Firm's disciplinary history is as follows:

- ☞ In February 1996, Firm E was fined \$2,570 pursuant to a consent order with State 1 regarding allegations that the Firm had done business in that state prior to being properly registered as a broker/dealer with the State;
- ☞ In December 1995, Firm E was fined \$2,380 pursuant to a consent order with State 2 regarding allegations by the State that the Firm had sold securities in State 2 prior to being properly registered with the State;
- ☞ In November 1995, Firm E was fined \$1,000 pursuant to a consent order with State 3, with regard to allegations by the State that the Firm had sold securities in State 3 without being properly registered with the State; and
- ☞ In November 1989, Firm E was cited by State 4 for failing to file required financial statements, and the Firm consented to a \$1,000 fine.

In addition, Firm E was also the subject of a formal action in 1988 instituted by the Association. This action stemmed from the Firm's failure to make proper deposits to its reserve account. The Sponsoring Firm consented to a Letter of Acceptance, Waiver and Consent ("AWC") finding violations of Article III, Section 1 of the Association's Rules of Fair Practice (now Conduct Rule 2110) and fining the Firm \$3,000.

Within the last three years, the Association has conducted two on-site examinations of the Sponsoring Firm. No formal disciplinary action was taken against the Firm as a result of either of these examinations. In connection with the 1997 examination, the Firm received a Letter of Caution for allowing individuals who were not properly registered as municipal securities principals to review the trading in municipal securities. In a September 1997 letter to the Association, the Firm promised to correct this situation by registering all of its general securities principals as municipal securities principals.

Discussion

The sole disqualifying event before us is X's 1991 conviction. Member Regulation opposes X's association with the Sponsoring Firm based on his failure to answer Question 22B of Form U-4 affirmatively, indicating that he was charged with a misdemeanor. Member Regulation believes that X should have recognized his obligation to answer this question affirmatively and also did not make adequate good faith efforts to obtain specific advice as to how to answer this question prior to

submitting the Form U-4. Member Regulation is of the view that letters submitted by X's attorney do not supply a sufficient justification for X's failure to disclose this information.

After a thorough review of the record, we approve X's association with the Sponsoring Firm. It is undisputed that X did not timely report his 1991 arrest on his Form U-4. Although we do not excuse X's failure to report, we do not believe that this conduct is sufficiently egregious to warrant denial of X's application. Although it is undisputed that X sought advice of counsel as to whether to report his 1991 arrest, he is unable to present specific proof that he also sought guidance from a regulatory authority to confirm his attorney's advice. We nonetheless find credible his contention that he did call a regulatory authority for confirmation. We have considered X's Form U-4 omission in light of the nature of his offense, its subsequent expungement, and the fact that the 1992 conviction was not a disqualifying event in 1992. We have also considered X's subsequent clean record as an associated person of the Sponsoring Firm and have determined that he should be given the opportunity to work in the securities industry.

The Sponsoring Firm proposes to have X supervised by the Proposed Supervisor, who has been with the Firm since May 1991. The Proposed Supervisor passed the Series 24 examination in May 1987 and has been registered as a general securities principal for 11 years. He has no disciplinary history nor is he the subject of any open examinations. The Proposed Supervisor's current title is Vice President/Sales Manager, and he currently supervises 27 registered representatives. The Sponsoring Firm is a bank-affiliated broker/dealer and houses its registered representatives in various bank locations. Because of this unique arrangement, the Firm does not provide daily, full-time supervision of its registered representatives, and it relies on its sales managers, such as the Proposed Supervisor, to conduct periodic on-site reviews and supervisory checks of the individuals assigned to each manager. X's office will be located within 30 miles of the Proposed Supervisor's office.

We conclude that the Sponsoring Firm and the Proposed Supervisor are qualified to supervise X and they have proposed an effective plan of supervision. The Sponsoring Firm will implement the following supervisory procedures until such time as X is no longer statutorily disqualified:

- (1) The Sponsoring Firm will record all of X's conversations with customers. Due to the fact that X is just establishing relationships with customers, it is expected that X will spend at least 30 hours a week telemarketing via the telephone. The Sponsoring Firm will ensure that its telemarketing rules are followed. In addition, the Proposed Supervisor will listen to a random sampling of 10 percent of these calls on a weekly basis. The Proposed Supervisor will document his review, and forward the results to the Compliance Department;
- (2) In addition to the designated principal, the Proposed Supervisor will review X's trades on a daily basis. The Proposed Supervisor will document this review by signing off on X's Daily Trade Blotter and forwarding a copy of this to the Compliance Department;
- (3) On a weekly basis, the Compliance Department will contact 10 percent of X's

customers who invest with the Sponsoring Firm. The purpose of these calls will be to ensure each customer's understanding of the investment, and that all required disclosures regarding the investment and the Sponsoring Firm were made. Evidence of these calls will be documented and maintained in the Compliance Department;

- (4) The Sponsoring Firm contracts with an outside firm to conduct "mystery shops" of its registered representatives. The shopper poses as a customer who would like to invest in, typically, a mutual fund or annuity. The registered representative is then scored on Sales, Style and Compliance. It is the Sponsoring Firm's policy that all registered representatives be "shopped" at least once a year. In addition, if they should score less than 80 percent in the compliance section, they are re-shopped. The Sponsoring Firm uses the shops to monitor its representatives and to determine if additional training or disciplinary action is necessary. Should X be allowed to act as a registered representative, the Sponsoring Firm would arrange for one Mystery Shop per quarter regardless of his score. Evidence of these shops, and their results will be maintained in the Compliance Department, and reviewed by the Proposed Supervisor;
- (5) The Compliance Department will conduct one examination per quarter of X and the bank branch in which he works. The examination results will be maintained in the Compliance Department;
- (6) The Proposed Supervisor is required to conduct an examination similar to the Compliance Examination of all registered representatives he supervises on an annual basis. The Sponsoring Firm will require the Proposed Supervisor to conduct quarterly examinations of X. These results will be forwarded to the Compliance Department;
- (7) X will be required to send copies of all outgoing correspondence to the Proposed Supervisor as well as the Compliance Department;
- (8) Should X receive any customer communication, a copy will be sent to the Proposed Supervisor for review;
- (9) Registered representatives at the Sponsoring Firm accept checks made payable to the Sponsoring Firm in order to settle trades. These checks are sent via an internal carrier service to the Operations Department. In addition, the representative is required to maintain a daily Check Receipt Blotter (with copies of all checks attached) which is an audit item. The Sponsoring Firm will require X to fax a copy of this blotter on a daily basis to CD; and
- (10) The Sponsoring Firm will provide advance notification to Member Regulation of any change in X's supervisor.

The Sponsoring Firm employs no other individuals who are subject to statutory disqualification.

The NASD certifies that: (1) X meets all applicable requirements for the proposed employment; (2) the Sponsoring Firm is not a member of any other self-regulatory organization; and (3) X and the Proposed Supervisor are not related by blood or marriage.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the registration of X as a general securities representative associated with the Sponsoring Firm will become effective within 30 days of the receipt of this notice by the Commission, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

Joan C. Conley
Senior Vice President and Corporate Secretary

LATER CASE HISTORY:

After this notice was filed with the SEC but before it was approved by the SEC, the SEC asked for certain additional information. To that end, the Sponsoring Firm represented the following:

- The Proposed Supervisor will visit X's office once a week on an unannounced basis.
- X will only be an employee of the sponsoring firm, not the Sponsoring Firm's bank affiliate.
- The Sponsoring Firm's bank affiliate employees, who are responsible for the facilities where X will be working, are not supervisors of X, but will be "very much aware" of his actions by visual and audio observation, and will be asked to provide the Proposed Supervisor with feedback concerning X's interactions with clients.

The Sponsoring Firm also represented the number of bank affiliate employees at each branch where X would be working, and provided physical layouts (floor plans) of those branches. Based on these representations, as well as the representations set forth in the June 1, 1999 notice, the SEC approved X's association with the Sponsoring Firm.