BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of the Association of X as a General Securities Principal, Chairman, CEO, and owner with The Sponsoring Firm	**Redacted Decision** Notice Pursuant to Rule 19d Securities Exchange Act of 1934 SD99013

A member firm ("the Sponsoring Firm"), has completed an MC-400 application ("Application") to permit X[1], a person subject to a statutory disqualification, to associate with the Sponsoring Firm as a general securities principal, Chairman and Chief Executive Officer ("CEO"), and 100 percent owner. In January 1999, a subcommittee of the Statutory Disqualification Committee of NASD Regulation, Inc. ("Hearing Panel") held a hearing on this matter. X appeared and was accompanied by his proposed supervisor ("the Proposed Supervisor"), the Director of Compliance at the Sponsoring Firm. BA and DB appeared on behalf of the Department of Member Regulation ("Member Regulation").

X entered the securities industry with Firm A in 1981. He was associated with Firm B from 1988 to 1990. X is subject to a statutory disqualification that arose from misconduct that occurred during the entire period that he was associated with Firm B.

X's Statutory Disqualification

[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.

The Securities and Exchange Commission ("Commission" or "SEC") instituted proceedings against X in 1994. In 1995, the Commission accepted an offer of settlement from X. Without admitting or denying the findings, X consented to the Commission's Order Making Findings and Imposing Remedial Sanctions ("SEC Order"). The SEC Order found that from 1988 to 1990, X was the de facto branch manager of a New York branch office of Firm B, a now defunct broker/dealer. Firm B was registered with the Commission from on or about 1987 to 1991. The SEC determined that from 1988 to 1990, five registered representatives employed in the Firm B branch office managed by X, willfully violated Section 17(a) of the Securities Act of 1933 ("Securities Act") and Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"). As the de facto supervisor of the New York branch, X failed reasonably to supervise these registered representatives with a view to preventing their violations of the antifraud provisions of the Securities Act and the Exchange Act, within the meaning of Section 15(b)(4)(E) of the Exchange Act.

The SEC Order stated that: 1) the five registered representatives made material misrepresentations and omissions in the offer and sale of securities by making baseless price predictions, misrepresenting the risk of investment in certain securities, and, as to four of the five registered representatives, making false representations that they possessed inside information regarding certain issuers; and 2) the five registered representatives made unauthorized securities trades in customers' accounts accompanied by deception, misrepresentations, and nondisclosure of material facts.

The SEC imposed the following sanctions on X:

1. A bar from associating in a supervisory or proprietary capacity with any broker, dealer, investment company, investment adviser or municipal securities dealer, with a right to reapply after three years with the appropriate self-regulatory agency;

2. Payment of restitution to certain customers of the five registered representatives in the amount of $326,562; and,

3. An undertaking by X that if he remained associated with the Sponsoring Firm during the three years that he was barred from associating in a supervisory or proprietary capacity, that the Sponsoring Firm adopt and implement certain compliance programs and procedures.

The Sponsoring Firm has been a member of the NASD since 1983. The Sponsoring Firm is organized as a corporation and X has been the sole owner since 1992. Since 1995, pursuant to the SEC Order, X's ownership of the Sponsoring Firm has been subject to the terms of a voting trust.

The Sponsoring Firm employs 182 registered representatives, 41 general securities principals, three options principals, and three municipal securities principals. The Sponsoring Firm is established as a full-service general securities business, which operates on a fully-disclosed basis through Firm C. Its primary business is agency commissions from equity securities and market making in six issues on the Nasdaq Stock Market. The Sponsoring Firm participated in two firm-commitment underwritings during 1997 as a selling group member and does a very limited amount of business in options, municipal bonds,

government bonds, and mutual funds. The Sponsoring Firm maintains approximately 10,500 customer accounts, of which about 6,500 are cash and 4,000 are margin. The Sponsoring Firm transacts about 500 tickets per day with the vast majority being customer trades and the remaining being proprietary trades. The Sponsoring Firm maintains four active branch offices.

Discussion

After careful review of the entire record in this matter, we conclude that the Sponsoring Firm's application to employ X as a general securities principal, Chairman and CEO, and 100 percent owner should be disapproved. We note, however, that Member Regulation has recommended that X's association with the Sponsoring Firm should be approved.

Legal Standard When the SEC Bars a Registered Person with a Right To Reapply. We consider this case under the guidance provided by the Commission In re Paul Edward Van Dusen, 47 S.E.C. 668 (1981). Under the Van Dusen precedent, when we evaluate an application from an individual who was barred by the Commission with a right to reapply, we consider:

1) any intervening misconduct in which the individual has engaged;

2) the nature and disciplinary history of the prospective employer; and,

3) the supervision to be accorded the applicant.

See id. at 671. In Van Dusen, the Commission stated that when it specifies a date after which an application for re-entry may be made, "the Commission upon a proper showing will generally act favorably upon the application." Id. at 671. As a general principle we do not consider the nature of the misconduct that was the basis for the Commission's bar with a right to reapply. See In re Arthur H. Ross, 50 S.E.C. 1082, 1084-85 & n.10 (1992). In this case we follow that general principle and we do not base our decision to disapprove this application on the conduct underlying the Commission's decision to bar X with a right to reapply in three years. We have based our decision to disapprove this application on the Sponsoring Firm's disciplinary history and supervisory structure.

Regulatory Actions Against the Sponsoring Firm

State Commissioner of Securities State 1 Cease and Desist Order. In 1998, State 1, acting through its Commissioner of Securities, issued a cease and desist order against the Sponsoring Firm and one of its securities agents ("Employee 1"). The State 1 Cease and Desist Order contains findings of fact that, while Employee 1 was employed by the Sponsoring Firm, he:

1. made unsuitable investment recommendations to an 82-year-old customer, MC, which resulted in the loss of 73 percent of the value of the customer's account;

2. purchased and sold, in a total of five transactions, shares of stock and warrants in the customer's account without authorization; and,

3. recorded incorrect information on the customer's new account form in that the customer had limited investment experience and an investment objective of growth, but Employee 1 recorded that the customer had 20 years of experience in trading equities and had investment objectives of short-term gain and speculation.

The State 1 Commissioner of Securities concluded that the Sponsoring Firm and Employee 1's conduct constituted an act, practice, or course of business that operated or would have operated as a fraudulent practice. Based on a finding that the Sponsoring Firm and Employee 1 had engaged in willful violations of the State's antifraud statute and that sufficient evidence existed to conclude that such fraudulent practices would continue, the State 1 Commissioner of Securities ordered the Sponsoring Firm and Employee 1 to cease and desist from the offer and sale of securities in violation of State 1's antifraud statute.

NASD Regulation District Office No. 3 Letters of Caution. In 1998, NASD Regulation issued a Letter of Caution to the Sponsoring Firm's Senior Vice President ("the SVP") . The Letter of Caution resulted from a customer who complained to the NASD Regulation's District No. 3 Office ("District No. 3") about the SVP's handling of his account. After reviewing the customer's account and the SVP's written statement about the account, District No. 3 stated that the 73-year-old customer's account was highly active, contained low-priced, speculative securities, and incurred $58,000 of commissions, which represented a large percentage of the account's value and a large percent of losses that were realized in the account. District No. 3 cautioned the SVP that no evidence supported the proposition that the activity in the account was compatible with the customer's previous investment experience and the customer's investment needs. While maintaining that the customer had wanted to use his account at the Sponsoring Firm as a speculative account, the SVP stated that he would "do everything necessary to make sure that this type of situation does not arise again." The SVP is still employed by the Sponsoring Firm as a supervisor of 10 registered representatives.

In 1998, the Associate Director of District No. 3 issued a second Letter of Caution to the Sponsoring Firm. The letter stated that, in 1996, another customer ("Customer") received a telephone solicitation to open an account with the Sponsoring Firm. The Sponsoring Firm salesman stated that he could make the Customer a lot of money and pressured her into revealing personal information, including her Social Security number. The Customer never authorized the purchase of any security. After she attempted to terminate the call, the salesman told the Customer to expect a packet in the mail and, if she was not satisfied, she could change her mind. The Customer later received a confirmation in the mail which showed that she had purchased 100 shares of Company 1, which were sold out for nonpayment.

The District No. 3 office also conducted an expanded inquiry into other customer complaints and other unexplained sellouts at the Sponsoring Firm. District No. 3 concluded that a number of the Sponsoring Firm's customers confirmed similar experiences, which involved a Firm salesperson

aggressively pitching them to purchase a security recommended by the Sponsoring Firm, the customer reaching no firm agreement to consummate a purchase, and ultimately the salesperson effecting an unauthorized purchase in the customer's account.

The Letter of Caution also stated that the Sponsoring Firm's written supervisory procedures were clearly inadequate because they failed to address the detection of unauthorized transactions that were later sold out for nonpayment. Specifically, the Sponsoring Firm had taped telephone calls of the Sponsoring Firm's compliance department confirming customer transactions after the transaction had been sold out for nonpayment. When District No. 3 listened to the tape, however, it learned that the tape had recorded only a series of unsuccessful attempts to reach nonpaying customers. District No. 3 informed the Sponsoring Firm that further reliance on this taping system would not be adequate to fulfill its responsibility to supervise potential unauthorized transactions.

Cycle Examination in 1997. NASD Regulation's District No. 11 Office conducted a routine examination of the Sponsoring Firm in 1997. To date, the examination has not resulted in the Department of Enforcement filing a complaint against the Sponsoring Firm nor has it resulted in a Letter of Caution. An exit conference that was sent to the Sponsoring Firm via a letter dated in 1998 noted that the Sponsoring Firm apparently violated NASD rules regarding written supervisory procedures concerning the Sponsoring Firm's continuing education program, late trade reporting, and other trade reporting violations.

SEC Examination. In a letter dated in 1998, the SEC informed the Sponsoring Firm that the SEC's broker-dealer examination revealed several violations of rules promulgated in the Exchange Act and NASD rules. The Sponsoring Firm's President responded to the SEC in a letter dated in 1998, in which the Sponsoring Firm acknowledged the following violations:

- The Sponsoring Firm failed to time stamp properly approximately 100 order tickets for Company 2 in 1997, in violation of Exchange Act Rule 17a-3(a)(6).

- The Sponsoring Firm allowed two customers to trade in options without written approval for such trading, in violation of NASD Rule 2860(b)(16)(B).

- The Sponsoring Firm failed to establish, maintain, and enforce written supervisory procedures for its operations department, in violation of NASD Rule 3010(b)(1).

- The Sponsoring Firm failed to report promptly a payment of $300,000 to a customer to settle his complaint against the Sponsoring Firm. The Sponsoring Firm also failed to report six additional claims for damages that were settled for amounts exceeding $25,000, in violation of NASD Rule 3070(a)(8).

- The Sponsoring Firm failed to report that a person associated with the Sponsoring Firm was the subject of allegations of misappropriations of funds.

The Sponsoring Firm disputed other conclusions in the SEC letter. We consider the most serious of these conclusions to be:

- That the Sponsoring Firm made false representations to the SEC concerning the whereabouts of audio recordings surrendered to the Sponsoring Firm by a customer as part of the Sponsoring Firm's settlement of the customer's complaint. The Sponsoring Firm contends that the Supervisor did not know that an attorney for the Sponsoring Firm had received the tape in question when the Supervisor represented to the SEC that the tapes were not in the Sponsoring Firm's possession;

- That the Sponsoring Firm failed to maintain copies of correspondence the Sponsoring Firm claimed to have sent to the FBI in response to a request. The Sponsoring Firm explained that, although it believed it had sent the correspondence to the FBI, it could not locate any copies of the documents;

- That the Sponsoring Firm failed to establish, maintain, and enforce properly an adequate system of supervision over two registered representatives ("Registered Rep 1" and "Registered Rep 2") in violation of NASD Rule 3010(a). The Sponsoring Firm responded that Registered Rep 1's forging of customer signatures could not be detected without notice and that it reasonably supervised Registered Rep 1 and Registered Rep 2.

Arbitration Claims Against the Sponsoring Firm. As part of the NASD Regulation District No. 11's cycle examination of the Sponsoring Firm conducted in 1997, it reviewed the Sponsoring Firm's arbitrations and settlements in 1996 and 1997. This examination established the following information: the Sponsoring Firm had made settlements and lost arbitration awards for a total amount of $1,345,344, which involved 27 different customers and resulted from customer complaints and arbitration claims. The bulk of the Sponsoring Firm's settlements were not accounted for by only a few large settlements; rather, the Sponsoring Firm paid $25,000 or more in each of 15 settlements. The one arbitration award during 1996 and 1997 involved customers DM and PM, who filed a claim against the Sponsoring Firm and one of its registered representatives in 1995. These customers alleged failure to execute, misrepresentation, omission of facts and breach of fiduciary duty. In 1997, the arbitration panel ordered Xs to pay more than $74,000 to the claimants and more than $4,000 in forum fees.

Assessment of the Nature and Disciplinary History of the Sponsoring Firm

We find several areas of concern in the disciplinary history of the Sponsoring Firm that cause us to disapprove of the Sponsoring Firm's application. Several incidents in the record demonstrate that the Sponsoring Firm has fallen short of the high standards of conduct that we require when a Firm is dealing with its customers and the investing public. The State 1 Commissioner of Securities Cease and Desist Order and the 1998 Letter of Caution from District No. 3 establish that the Sponsoring Firm allowed its registered representative to effect unauthorized trades in its customers' accounts and to recommend unsuitable investments. In the case of customer MC, he suffered significant harm in that his account lost 73 percent of its value based on the recommendations of the Sponsoring Firm's registered

representative. Likewise, the Letter of Caution to the SVP documents another instance of a person registered with the Sponsoring Firm harming a customer.

We also find that additional evidence in the record bolsters our conclusion that the Sponsoring Firm is not qualified to employ a statutorily disqualified person as a registered principal of the Sponsoring Firm. Part of the Sponsoring Firm's supervisory structure for detecting when its registered representatives effected unauthorized transactions was to have its compliance department call customers who had not paid for securities and confirm that the customer had authorized the transaction. When the Sponsoring Firm provided a tape of these purported confirming telephone calls to District No. 3, however, it did not contain any discussions between customers and the Sponsoring Firm's compliance department. Rather, the recording contained only a series of unsuccessful attempts to reach customers. Moreover, at the hearing, X and the Supervisor testified that for one and one-half years in 1996 and 1997, the Sponsoring Firm tape recorded these telephone calls, but used only one tape the entire time, causing old material to be taped over. This lack of a record of the Sponsoring Firm's investigating potential unauthorized transactions is a serious lapse in maintaining investor protection in its own right. In addition, we conclude that the Sponsoring Firm has made inadequate efforts to stop its registered representatives from effecting unauthorized trades. Our conclusion is based both on District No. 3's finding that the Sponsoring Firm's customers complained of unauthorized transactions and the State 1 Cease and Desist Order's finding that the Sponsoring Firm had allowed its registered representative to effect five unauthorized trades.

We view certain of the SEC's findings as adding to our concerns. The SEC found that the Sponsoring Firm failed to report seven arbitration settlements of more than $25,000 and that it failed to report that a person associated with the Sponsoring Firm was the subject of allegations of misappropriation of funds. This omitted information had the effect of keeping important information about the Sponsoring Firm away from the SEC, NASD Regulation, and the investing public.

We also find that the Sponsoring Firm's compliance record indicates a lack of diligence in protecting the financial interests of its customers. Based on our experience in the securities business, we find that settlements of arbitration claims and arbitration awards of more than 1.3 million dollars over a period of two years for a firm of this size signifies lax supervision over sales practices within the Sponsoring Firm. We especially note that several of the arbitration cases and arbitration settlements involved allegations of sales practice abuses by the Sponsoring Firm.

Based on numerous examples in the record of the Sponsoring Firm's violations of SEC and NASD rules, we conclude that the Sponsoring Firm's disciplinary history contains far too many violations to allow X to associate with the Sponsoring Firm as a general securities principal, Chairman and CEO, and 100 percent owner.

We have considered X's claim that once he is permitted to resume an active management role, he would strengthen the Sponsoring Firm's commitment to compliance matters. Our decision to disapprove the Sponsoring Firm's application is based on the Sponsoring Firm's compliance problems as demonstrated over the last several years. In contrast to these documented problems, X's claim of

improved management is speculative because he has not been engaged in the management of a broker/dealer for the last three years. We will not approve the Sponsoring Firm's application based on the unverifiable assumption that X will solve the Sponsoring Firm's compliance problems.

Assessment of the Supervisory Structure Proposed by the Sponsoring Firm

The Sponsoring Firm proposes that X function as a general securities principal, Chairman and CEO, and that he re-take voting control over 100 percent of the Sponsoring Firm's stock. The Sponsoring Firm also proposes that X resume senior management responsibilities and take charge of the Sponsoring Firm's overall business strategy, market focus, direction, and operating activities. The Sponsoring Firm proposes that the Proposed Supervisor supervise X's activities as discussed below. Under the Sponsoring Firm's proposal, X would have no direct supervisory responsibilities over any registered representative acting in a sales capacity and would not himself plan to function in a sales capacity as a registered representative. Should X function in a sales capacity, he will be directly supervised by Employee 2.

The Proposed Supervisor has been employed by the Sponsoring Firm for a total of approximately two and one-half years, having worked for the Sponsoring Firm from 1995 through 1997, and again from 1998 to the present. From 1997 to 1998, he was associated with three securities firms: Firm F, Firm G, and Firm H. The Proposed Supervisor is 28 years old and is a general securities principal and registered options principal. Since 1998, he has been Director of Compliance for the Sponsoring Firm and had been Assistant Director of Compliance for approximately 10 months before his promotion.

The Proposed Supervisor has been the subject of two cause exams, both filed without action. The Proposed Supervisor has been the subject of one arbitration, initiated in 1998, charging him with failure to supervise. The arbitration was settled against the Supervisor for $20,000 without any admission or denial of liability. The Sponsoring Firm maintains that the Supervisor did not contribute to the settlement, and was incorrectly named in the arbitration because the activity that was the subject of the arbitration occurred prior to the Proposed Supervisor's association with the Sponsoring Firm.

The Sponsoring Firm and the Proposed Supervisor have proposed the following plan of supervision for X for two years:

1. X shall not be the direct supervisor of any registered representative acting in a sales capacity.

2. a. X shall be restricted in his abilities to discipline or terminate unilaterally the Sponsoring Firm's Director of Compliance (the Proposed Supervisor), or the branch office manager (Employee 2) responsible for direct supervision of X in the event he functions in a sales capacity, for reasons related to supervision of X's activities. X cannot take such action without the concurrence of "the Judge", a retired State 2 Judge (or his successor, as set forth herein), except as set forth below.

b. In the event the Judge declines to concur, in order to take the proposed action X must obtain approval of a majority of the Sponsoring Firm's Board of Directors and provide prompt written notice thereof to NASD Regulation's District Office No. 10.

c. If the Proposed Supervisor is terminated or Employee 2 is replaced, the Sponsoring Firm shall provide written notice to NASD Regulation.

3. In the event the Judge is unwilling or unable to serve in the capacity described herein, or in the event X desires to replace the Judge, X must provide prior written notice of the name of the proposed successor, who shall not be unacceptable to Member Regulation. Member Regulation shall act timely and reasonably in reviewing and responding to such notice.

4. The Proposed Supervisor is required to meet with X quarterly to review X's supervisory activities and any equity trading executed by X. A log should be kept of these meetings.

5. X is prohibited from engaging in equities trading as a Series 55 registered person until such time as the Director of Compliance or another Series 55 registered person is available to supervise him.

6. All customer complaints, written or verbal, that allege any wrongdoing or sales practice violation committed by X shall be referred to the Director of Compliance. Copies of any such complaints that are in writing shall be provided to NASD Regulation within five business days.

7. In the event X executes trades on behalf of customer accounts, the appropriate branch office manager shall review and approve his order tickets on a daily basis, and review any incoming and outgoing correspondence relating to such customer accounts. The appropriate branch office manager shall meet with X quarterly to review any retail sales activities performed by X and maintain a record of such meetings. If X does not engage in any such activity during the relevant period, a notation should be made in the record.

8. The conditions set forth herein shall be reflected in a writing maintained at the Sponsoring Firm and copies thereof shall be provided to those persons who have some duty or responsibility hereunder, including the Judge, the Board of Directors, the Director of Compliance, and the appropriate branch office manager.

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

We disapprove of the Sponsoring Firm's application on the additional grounds that we conclude that the Proposed Supervisor lacks the experience required to supervise properly an individual who will be 100 percent owner, Chairman and CEO of the Sponsoring Firm, and a general securities principal. We find that the SVP supervising X is a mismatch because X has 18 years of experience in the securities business as compared to three and one-half years for the SVP. After hearing the SVP discuss

the task of supervising X, we further find that he lacks the knowledge of the details of Firm's business necessary to supervise X properly.[2]

The Sponsoring Firm has proposed a supervisory structure that falls short of the heightened supervision that we require for statutorily disqualified persons because the SVP lacks the experience required to undertake effective supervision of X and also lacks the knowledge required to supervise X effectively. We therefore disapprove the Sponsoring Firm's application.

We have also considered the Sponsoring Firm's response to the suggestion by the Hearing Panel that the Sponsoring Firm revise its application and agree to: 1) select a more experienced general securities principal, acceptable to NASD Regulation, to supervise X's activities; and, 2) retain an independent consultant, acceptable to NASD Regulation, to conduct examinations covering the Sponsoring Firm's compliance and supervisory procedures for five years. The Sponsoring Firm responded by declining to offer a more experienced supervisor for X and suggesting the retention of an independent consultant who would -- after an initial review of the Sponsoring Firm's compliance and supervisory procedures -- periodically review the Sponsoring Firm for two years. We are of the opinion that the Sponsoring Firm's proposal does not overcome the problems with the Sponsoring Firm's compliance record and the deficiency in the Sponsoring Firm's proposed supervision for X.

Accordingly, we disapprove of the Sponsoring Firm's application to allow X to associate with the Sponsoring Firm as a general securities principal, 100 percent owner, and Chairman and CEO. We conclude that our disapproval is in the public interest and serves the goal of investor protection.

On Behalf of the National Adjudicatory Council,

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Joan C. Conley
Senior Vice President and Corporate Secretary

[2] Our conclusion that the Sponsoring Firm's proposed supervisory structure is inadequate is a separate and independent basis for our disapproval of Firm's application.