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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	
Complainant,	Disciplinary Proceeding No. C07970055
v.	
	DECISION Hearing Panel
	Dated: March 20, 1998
Respondent.	

Digest

On July 29, 1997, the Department of Enforcement ("Enforcement") served a Complaint on Respondent ______________ ("Respondent"), alleging that Respondent, a registered principal, violated NASD Conduct Rules 2110 and 3010. Enforcement alleged that Respondent violated such rules by failing to supervise ________ ("____") and thereby failing to detect that ____ had made unauthorized trades in a customer's account. The Hearing Panel found that Respondent failed to adequately supervise ____ with respect to the account of the public customer. However, under the specific circumstances of this case, the Hearing Panel determined that a letter of caution was the appropriate sanction. The Hearing Panel also assessed the costs of the Hearing against Respondent.

Appearances

Alan M. Wolper, Regional Counsel, Atlanta, Georgia, for the Department of Enforcement.

______________, Assistant General Counsel of ________________ for Respondent.

DECISION

I. Procedural Background

On July 29, 1997, Enforcement served the Complaint on Respondent. The District Business Conduct Committee for District Seven had authorized the Complaint. On August 22, 1997, Respondent filed an Answer with the Office of Hearing Officers ("Office") and requested that the proceeding be administered under the new Code of Procedure ("Code").[1] By Order dated August 26, 1997, the Hearing Officer directed Enforcement to file a copy of the Complaint with the Office or, in the alternative, to file a motion stating why the proceeding was not eligible to be administered under the new Code.

Enforcement filed a copy of the Complaint with the Office on September 2, 1997, in which it alleged that Respondent failed to adequately supervise ____, a former employee of _____________. ("______"). The Complaint alleged that, because of Respondent's failure to supervise ____, ____ was able to effect 17 securities transactions in the account of one customer (the "Customer"), without that Customer's prior knowledge or authorization.

The Complaint alleged specifically that Respondent failed adequately to supervise ____ because: (1) Respondent did not review ____ posting book; (2) Respondent instructed ____ to update the Customer's new account form without personally checking with the Customer to confirm that the Customer's investment objectives had changed;

(3) Respondent failed personally to follow-up with the Customer when the Customer did not return the activity letters that had been sent to him; and (4) Respondent failed to review all communications that the Customer sent to ____ by facsimile complaining of ____ failure to respond to telephone calls. Respondent stipulated that the 17 securities transactions did occur and were unauthorized, but denied that his supervision of ____ was inadequate.

The Parties presented evidence to a Hearing Panel in a one day hearing on December 2, 1997, in Fort Lauderdale, Florida.[2] Enforcement presented two witnesses at the Hearing, the Customer and an NASD compliance examiner. Respondent presented two witnesses, Ms. __________ ("_________"), a former ______ compliance officer,[3] and himself.

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[1] On August 7, 1997, the Securities and Exchange Commission ("SEC") approved and declared effective, as of that date, the new Code to govern the NASD's disciplinary proceedings. Pursuant to the transition provisions of the new Code, Respondent was eligible to proceed under the new Code.

[2] References to the testimony set forth in the transcript of the Hearing will be designated as "Tr.". References to Exhibits presented by Respondent will be designated as "RX- ,". References to Exhibits presented by Enforcement will be designated as "CX- , ".

[3] ______ is currently the co-manager of the ______ Fort Lauderdale Office.

II. *Findings of Fact and Conclusions of Law*

Most of the facts in this proceeding are undisputed.[4]

A. Respondent's Background

Respondent first entered the securities industry in November 1983 when he became associated with E. F. Hutton & Co., Inc. ("Hutton"). (Stp. at ¶1). After working as a registered representative with several other broker-dealers, Respondent was hired by ______, Incorporated[5] in April 1993 as a branch manager for ______ Fort Lauderdale Office, where he currently is employed. (Tr. at 122; Stp. at ¶1). When he was hired by ______, Respondent transferred his customers and concentrated on management and supervision. (Tr. at 123). In July 1995, Respondent qualified as a General Securities Principal. (Stp. at ¶1).

Respondent had been a branch manager of the Fort Lauderdale Office for approximately two years at the time that the unauthorized transactions involved in this proceeding occurred. (Tr. at 122). During the relevant periods mentioned herein, including the date that the Complaint was served, Respondent was registered with and is subject to the Association's jurisdiction.

During the Hearing, Enforcement presented no evidence that Respondent had a disciplinary history or had a history of failing to follow ______ policies and procedures. Respondent presented evidence indicating that, in several instances, he exercised more stringent

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[4] See Stipulated Facts filed with the Office on November 27, 1997. The particular stipulations set forth in "Stipulated Facts" will be designated as "Stp. at ¶ ".

[5] ______, Incorporated is the predecessor of ______, L.L.C. (Stp. at ¶1).

controls[6] in the Fort Lauderdale Office than required by ______ Compliance Procedures Manual ("______ Manual") as in effect in 1995. (Tr. at 136-138, 150, and 168).

B. ____ Background

____ initially entered the securities industry in October 1993 by becoming associated with ______.[7] (Stp. at ¶3) Respondent interviewed and hired ____ to work in the Fort Lauderdale Office and was his direct supervisor. (Tr. at 156; Stp. at ¶4). From October 1993 through June 1995, ____ had no disciplinary problems; Enforcement did not present any evidence that ____ failed to follow ______ policies and procedures during this time period. (Tr. at 160). ____ resigned from ______ on October 11, 1995 for personal reasons. (Tr. at 170; CX-19, 4).

C. ______ Background

______ is currently a co-manager for the Fort Lauderdale Office. (Tr. at 258). She started in the securities industry in 1982 as an unregistered sales assistant for ___________. (Tr. at 258). In 1985, ______ acquired ___________, and ______ began working for ______ as an account executive. (Tr. at 258). In 1990, she transferred to ______ compliance department (the "Compliance Department") as a compliance administrator. (Tr. at 258). From January 1990 until June 1, 1993, she worked in the New York Office of the Compliance Department. (Tr. at 258-259). On June 1, 1993, she became the on-site regional compliance

[6] For example, ______ option forms permit a customer to engage in option trading at levels one, two, three, or four: level one being covered calls, level two being buying and selling of options, level three being spread transactions and level four being naked option trading with the highest risk. Respondent did not approve level three or level four option trading for any customers in the Fort Lauderdale Office. Respondent also instituted a policy that a new options customer must sign an options risk letter along with his first option transaction. (Tr. at 136-138).

[7] ____ qualified as a General Securities Representative in February 1994. (Stp. at ¶3).

officer in the Fort Lauderdale Office. (Tr. at 259). She worked in that capacity until June 12, 1996, when she left ______ and went to work at ___ as the associate director of compliance. (Tr. at 259). After working for ___ for one year, ______ returned to ______ as co-manager in the Fort Lauderdale Office in June 1997. (Tr. at 259).

D. Unauthorized Trading

____ opened a ______ account for the Customer in January 1995.[8] (Tr. at 36). Through May 1995, the Customer approved a number of trades for his account in New York Stock Exchange listed securities without incident. (Stp. at ¶6; Tr. at 50). Between June 14, and June 28, 1995, however, while the Customer was on vacation, ____ effected 11 unauthorized trades in the Customer's account. (Stp. at ¶6). Between July 6, and July 25, 1995, ____ effected six additional unauthorized trades in the Customer's account. (Stp. at ¶8). ____ liquidated all the positions in the Customer's account on July 25, 1995, pursuant to the Customer's instructions. (Stp. at ¶9).

When the Customer called ____ to complain about the unauthorized transactions, ____ told the Customer he would make it up to him. (Tr. at 46). The Customer did not contact Respondent immediately because ____ begged him not to, saying he didn't want to lose his job. (Tr. at 47). After a number of unsatisfactory contacts with ____, the Customer contacted Respondent directly on October 11, 1995. (Tr. at 48).

During the October 11 contact, Respondent arranged to meet with the Customer on October 12. (Tr. at 48-49). The Customer also spoke with ______ on October 11. (RX-8).

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[8] ____ opened the Customer's account after cold calling him. (Tr. at 36). The Customer was 83 years old at the time. (Tr. at 36).

Respondent initially requested that the Compliance Department meet with the Customer, but the Compliance Department directed Respondent to meet with the Customer first. (Tr. at 197). On October 12, Respondent and the Customer met and discussed the unauthorized trades. (Tr. at 50). Respondent subsequently referred the matter to the Compliance Department pursuant to ______ policy.[9] (RX-1, 108; Stp. at ¶21).

Initially, in a letter dated November 10, 1995, ______ denied liability for the Customer's losses. (CX-12). ______, however, eventually reimbursed the Customer $12,000 for his losses on the unauthorized trades. (Tr. at 55). Respondent testified that he requested that ______ reimburse the Customer in 1997 after an NASD disciplinary proceeding found that ____ had effected unauthorized transactions in the Customer's account. (Tr. at 206).

E. Respondent's Supervisory Activities

Respondent detailed how he executed his supervisory duties for approximately 3,000 accounts as the Fort Lauderdale Branch Manager. (Tr. at 134). Respondent testified that he engaged in various supervisory activities on a daily, monthly, or as needed basis. In particular, he conducted daily training meetings with his account executives, which sometimes included outside guests. (Tr. at 156-157). Respondent also testified that he reviewed on a daily basis every order ticket that was written in the branch and the BPS-29 Report.[10] (Tr. at 125-126). On a monthly basis, he reviewed client account statements and the status of customer

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[9] Upon receipt of a customer complaint, the Compliance Department would send a letter of acknowledgment to the customer. (RX-1, 108). After completing its review, the Compliance Department would forward a written response to the customer outlining ______ position. (RX-1, 108).

[10] The BPS-29 Report is a daily computerized listing of all transactions, sorted by account executive and account number. (RX-1, 213). This report contains the client's name, the name of the security purchased, sold, or sold short, the quantity, whether an option transaction was "opening" or "closing," the price and commission, and whether the account is discretionary, related, or blocked. (RX-1, 213).

complaints as listed by the Compliance Department. (Tr. at 134-135). Respondent also reviewed on an as needed basis customer accounts that ______ restricted from further trading, so called “blocked accounts.” (Tr. at 130). Respondent further testified that it was his practice to review every account executive’s posting book twice a year or more. (Tr. at 139).

F. Allegations

Enforcement based its failure to supervise allegations against Respondent on four specific supervisory lapses: (1) failure to review ____ posting book; (2) failure to personally contact the Customer to confirm his changed investment objectives; (3) failure to contact the Customer after the Customer failed to respond to ______ activity letters; and (4) failure to review all communications that the Customer had faxed to ____ complaining that ____ had not returned the Customer’s telephone calls.

1. *Failure to Review ____ Posting Book*

The branch managerial reports do not indicate that Respondent reviewed ____ posting book in 1995, and Respondent does not recall whether he reviewed it. (CX-17; Tr. at 213). Respondent acknowledged that it was possible that he decided to investigate the investment objectives of the Customer based on information other than a review of ____ the posting book. (Tr. at 166). Nevertheless, Respondent reasoned that it was probable that his review of ____ posting book precipitated the updating of the Customer’s account form, and, therefore, that he must have reviewed the posting book prior to June 28, 1995. (Tr. at 213). Respondent testified that clerical error explained the absence of a reference to the review of the posting book on his branch managerial reports for 1995. (Tr. at 208). ______ testified that in her three years as regional compliance officer she had never known Respondent to fail to review a posting book. (Tr. at 261).

The Hearing Panel has reviewed the evidence and does not find that Respondent's questions regarding the Customer's investment objectives as reflected in his account form necessarily followed from a review of ____ posting book. The Hearing Panel specifically finds that Respondent's review of other reports or trading records is a more plausible explanation as to why Respondent directed that the Customer's account form be updated to reflect additional investment objectives. In this regard, Respondent testified that he would have reviewed ____ posting book at the same time that he reviewed the other registered representatives' posting books for the month of June. (Tr. at 239). The June 1995 branch managerial report indicates that Respondent reviewed a group of posting books between July 18, 1995 and July 21, 1995, which occurred after the June 28, 1995 change in the Customer's investment objectives.[11] (CX-17, 9).

The Hearing Panel concludes that Respondent did not review ____ posting book as required by ______ policies and procedures. Although this lapse constituted a supervisory failure, it was not particularly significant under these circumstances. Respondent was sufficiently aware of the Customer's securities activity to discuss with ____ the need to amend the Customer's investment objectives as listed on the account form.

[11] Respondent's prior review of posting books occurred on May 18, 1995, which predated ____ unauthorized trading. (CX-17, 8).

2. *Updating of Customer's Account Form*

On or about June 28, 1995, following Respondent's review of the recent trading activity in the Customer's account, Respondent directed that the Customer's account form be updated to add "growth" and "speculation" as investment objectives to the original investment objective of "trading." (Stp. at ¶7). Respondent did not call the Customer personally in connection with updating the account form. (Stp. at ¶7). Respondent received ____ assurances that the Customer had sanctioned the transactions that necessitated a change in the investment objectives. (Tr. at 254). There were no previous indications that ____ could not be trusted. (Tr. at 174).

The Customer's updated account form, with a completed account transmittal form showing the Customer account number as 08534, was sent to the New York office as a new account form.[12] (RX-10). Respondent believed that a copy also would be forwarded to the Customer. (Tr. at 142). The Customer testified that he had no recollection of receiving the original account form, and that he never received the updated one. (Tr. at 52-53).

______ testified that ______ policy, at least since 1989, had been that both new and updated account forms be completed by account executives, approved by branch managers, and sent to ______ New York Office. (Tr. at 261-262). The New York Office then would send a cover letter to the client with the new or updated account form. (Tr. at 262).

[12] ______ Manual provides that new account forms should be completed by the account executive. (RX-1, 10). New account forms are attached to a fully completed account transmittal form, sent to the New Accounts Department and then forwarded to the customer for verification. (RX-1, 10, 16). ______ Manual does not require the forwarding of updated account forms to customers. (RX-1).

Respondent's Exhibit 2A includes such a form cover letter from the New York Office. (RX-2A, 7).

The Hearing Panel finds that Respondent believed that the updated account form would be forwarded to the Customer and that Respondent's belief was reasonable under the circumstances. The Hearing Panel also finds that there were insufficient red flags to alert Respondent to a possible problem with the Customer's account on June 28, 1995.[13] The Hearing Panel, therefore, concludes that Respondent's reliance upon ____ assurances that a change in investment objectives was authorized was reasonable. Consequently, Respondent's failure to contact the Customer personally before directing the updating of the account form was not a failure to adequately supervise.

3. *Follow up on Activity Letters*

______ Client Services Department in New York sent an activity letter to the Customer on July 27, 1995, based on the trading activity in the Customer's account during the second quarter of 1995.[14] (Stp. at ¶10; RX-3). The Customer testified that he received this activity letter. (Tr. at 61). Although ______ requested that the Customer sign and return the letter to

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[13] See, e.g., District Business Conduct Committee No. 2 v. Peter J. Martinez, Complaint No. C02940024, 1995 NASD Discip. LEXIS 29, *18-19 (NBCC March 23, 1995). Typical red flags include customer complaints, a prior disciplinary record, irregularities in the trading pattern of the account, and specific transactions listed on supervisory reports.

[14] ______ managers are supplied with a quarterly active account report that identifies all accounts that generate $5,000 or more in commissions in a quarter, or effect fifteen or more transactions in a quarter, and whose commission versus equity ratio exceeds 2.5%. (RX-1, 215). For all accounts listed on the quarterly report, managers either are required to submit one of four activity letters to be forwarded to the client by the Compliance or Client Services Department or are required to submit an activity review form to the Compliance Department, explaining why an activity letter to the client is not warranted. (RX-1, 215). Respondent testified that, when an account appeared on the quarterly active account report, he always had the Compliance Department send an activity letter to the client; he never filed an activity review form. (Tr. at 150).

confirm the accuracy of its contents, he did not do so. (Stp. at ¶10). Moreover, although the letter also invited the Customer to call with any questions about his account, he did not do so. (Stp. at ¶10).

On August 17, 1995, ______ Client Services Department sent a second activity letter to the Customer because the Customer had not signed and returned the first one.[15] (Stp. at ¶15). The second letter was almost identical to the first. (RX-4) The Customer testified that he received the second activity letter, dated August 17, 1995, two or three days after it was mailed, but did not sign or return it. (Tr. at 63; Stp. at ¶15). He also did not call ______ regarding his account. (Stp. at ¶15). On September 5, 1995, ______ blocked the Customer's account because he had not responded to the second activity letter. (Tr. at 179).

Respondent was familiar with ______ activity letter and account restriction processes. In light of ______ policies, the Hearing Panel finds that the Respondent did not act unreasonably when he failed to contact the Customer after the Customer did not respond to the first activity letter. However, in this case, Respondent had received on August 9 and August 14, 1995 two faxed letters[16] sent by the Customer that complained to ____ about his responsiveness. Respondent should have considered the two letters in determining whether he should contact the Customer when the Customer failed to respond to the second activity letter that was mailed on August 17, 1995.

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[15] If, after a two-week period, an activity letter that has been sent to a customer is not signed and returned, the New York Office of ______ will then send a second activity letter to the customer. (RX-1, 214). If, after an additional two weeks, the second letter is not signed and returned, ______ policy is to block the account and not permit trading until the branch manager speaks with the customer and approves the trade. (Tr. at 152-154).

[16] The faxed letters are discussed in more detail in subsection 4, infra.

Failure to supervise can arise where a supervisor is aware only of red flags or suggestions of irregularities.[17] By the time ______ Client Services Department mailed the second activity letter to the Customer on August 17, and certainly when the Customer's account was restricted from further trading on September 5, Respondent was aware of sufficient red flags to warrant a more proactive stance with regard to the Customer account.

____ lack of a history of regulatory violations does not justify Respondent's continuing reliance on ____ explanations.[18] In the context of (i) a change in investment objectives, (ii) liquidation of the account, (iii) a failure to respond to the first activity letter, and (iv) two letters from the Customer, the Hearing Panel concludes that Respondent's failure to contact the Customer when the Customer did not respond to the second activity letter was a failure to adequately supervise ____.[19]

4. *Failure to Review Customer's Facsimile Letters*

On August 9, the Customer faxed a letter to ____ at ______. (Stp. at ¶11). The letter stated that ____ had not returned the Customer's phone calls, but contained no information regarding any unauthorized transactions. (CX-5). Respondent received a copy of the letter and instructed ____ to call the Customer. (Stp. at ¶12). The Customer faxed a second letter to

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[17] District Business Conduct Committee for District No. 8 v. Freedom Investors Corporation, Complaint No. C8A950011, 1997 NASD Discip. LEXIS 21, at *43, 44 (NBCC January 27, 1997)(citing Shearson Lehman Hutton, Inc., Exchange Act Release No. 26766, 43 S.E.C. Docket 1322 (April 28, 1989), 1989 WL 257097 at *4-5).

[18] District Business Conduct Committee for District No. 6 v. Dickinson & Company, Inc., Complaint No. C06930056, 1995 NASD Discip. LEXIS 45, at *25 (NBCC December 7, 1995).

[19] In the view of the Hearing Panel, Respondent should have promptly forwarded to the Compliance Department the letter that the Customer faxed to ____ on August 14, 1995 complaining about ____ failure to contact him.

____ at ______ on August 14. (Stp. at ¶13, 14). That letter, which Respondent received, complained that ____ had not kept his promise to call and further threatened to go over ____ head and speak with the individual in the Client Services Department who had written the first activity letter. (CX-6).

Respondent testified that he did not view either of these two letters as a customer complaint. (Tr. at 227). Respondent testified that a reportable complaint would be one that alleged one of five things, including unauthorized trading, churning, misrepresentation, and fraud.[20] (Tr. at 244). ______ confirmed Respondent's interpretation of ______ Manual. (Tr. at 271). She stated that, if such complaints were in writing, they would be referred to the Compliance Department.[21] (Tr. at 272).

At this time, Respondent, rather than contacting the Customer directly, immediately instructed ____ to call the Customer. (Stp. at ¶14). Respondent stood by ____ while ____ dialed the Customer. (Stp. at ¶14). Respondent did not stay to listen to the entire conversation, but left after it appeared that ____ had reached the Customer. (Stp. at ¶14). At the Hearing, Respondent stated that, in hindsight, it would have been the better practice for him to have contacted the Customer directly after receiving the second letter. (Tr. at 207).

According to ______ Manual, copies of customer complaints or any other indications of potential problems should be immediately forwarded to the Compliance Department for

[20] Respondent did not indicate the fifth category of reportable complaints. (Tr. at 244).

[21] ______ agreed with Respondent's description of sales practice customer complaints, but added that there were also non-sales practice related matters that should be referred to the Compliance Department. (Tr. at 271). For example, a written customer complaint alleging a failure to receive a dividend payment should also be referred to the Compliance Department. (Tr. at 271).

processing. (RX-1, 119). The Hearing Panel believes that the Respondent certainly could have interpreted the Customer's first letter as an indication of possible problems with the Customer's account, but that such a conclusion is not necessarily required. However, the Hearing Panel believes that the second letter was clearly an indication of a problem. Respondent should have treated the second letter as a customer complaint and forwarded it to the Compliance Department.[22]

The Customer faxed a third and fourth letter to ____ on August 28 and September 12, 1995. (Stp. at ¶16, 18). Respondent does not remember receiving either of the letters, and Enforcement presented no evidence that Respondent received them.[23] (Stp. at ¶17, 19)

The fax machine in the Fort Lauderdale Office was in a secured area, and the office staff with access to the fax machine was instructed to provide the branch manager with a copy of all faxes. (Tr. at 144). ______ testified that the New York Stock Exchange examined the Fort Lauderdale Office in 1993, 1994, and 1995 and that the office was not cited for any deficiency regarding incoming correspondence, incoming fax procedures, or the security of the fax. (Tr. at 268). She also testified that ______ Internal Audit Department reviewed the Fort Lauderdale Office on an annual basis. (Tr. at 269). According to her testimony, none of the

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[22] ______ stated "There is nothing in either one of these letters that would indicate that it would be something that the Compliance Department would open as a complaint." (Tr. at 271).

[23] The Customer faxed a fifth letter to ____ on September 20, 1995. (Stp. at ¶20). Respondent currently remembers receiving the fifth letter and testified that he spoke with the Customer in response to the letter. (Tr. at 190-193). Respondent's recollection is based on a copy of the letter that includes his handwritten notes, which ______ located in a 1997 review of Respondent's files. (Tr. at 190; RX-6). The Hearing Panel, however, does not believe that Respondent's recently refreshed recollections regarding a September 20, 1995, conversation with the Customer are accurate. The Customer testified that, until October 11, 1995, he had not spoken with, and he had not attempted to contact, anyone other than ____ at ______. (Tr. at 56). The Hearing Panel credits the Customer's testimony and, therefore, finds that it was not until October 11, 1995 that the Customer spoke with someone other than ____ at ______.

annual examinations by Internal Audit or Compliance Department found a deficiency in the Fort Lauderdale Office relating to the security of the fax machine or procedures for incoming faxes. (Tr. at 269). The Hearing Panel finds ______ testimony credible and finds that there generally were adequate procedures in place regarding faxed communications to which Respondent adhered. Despite these procedures, the Hearing Panel finds that Respondent did not actually receive the August 28 and September 12, 1995 letters.

There is no evidence that Respondent changed the fax procedures in a way that would have resulted in his not receiving the other two faxes. The Hearing Panel attributes Respondent's failure to receive the other two faxes to unknown mechanical failure or human error. The Hearing Panel concludes that Respondent did not deliberately fail to review all communications sent by the Customer to ____.

III. Sanctions

The Hearing Panel has determined that a letter of caution is the appropriate sanction for Respondent in this proceeding. The Hearing Panel also is assessing Respondent with the costs of the Hearing in the amount of $2,561.80.

The NASD Sanction Guidelines recommend a fine of $5,000 to $25,000 and a suspension of 10 to 30 business days for individuals in a typical case of inadequate supervision.[24] The Sanction Guidelines identify a number of factors adjudicators should consider in determining the appropriate sanctions for an individual who has violated Rule 3010. Principal considerations include: (1) prior or other similar misconduct; (2) extent of inadequacy in written supervisory procedures and controls; (3) extent of supervisor's periodic review and follow-up; (4) red flag warnings that should alert the principal to intensify supervision, such as the disciplinary history of the supervised person; (5) extent of any inadequacy in the actual supervision of the employee; (6) absence of any reasonable explanation for the supervisory failure; and (7) extent of employee misconduct. As discussed in more detail below, the Hearing Panel determined that lesser sanctions were appropriate in this case.

A. Prior Misconduct

One of the principal considerations in determining a sanction is prior or other similar misconduct. Respondent has no prior disciplinary history.

B. Adequacy of Written Supervisory Procedures/Reasonable Explanation

The Hearing Panel determined that the manner in which the Compliance Department implemented ______ Manual corresponded to having inadequate written supervisory procedures and, therefore, provided a partial explanation for Respondent's actions. In the Hearing Panel's view, written policies that set forth reasonable standards are only the first step in providing adequate supervisory policies. Implementation and procedures to verify implementation are equally important steps in the process of providing adequate supervision. In this case, although ______ policies as written may have been reasonable, the Compliance Department actually implemented and enforced the policies in a manner inconsistent with the written policies and therefore did not meet the important steps of implementation and

[24] NASD Sanction Guidelines 53 (1996).

verification.[25] The Hearing Panel finds that ______ implementation of its policies and procedures contributed to Respondent's supervisory lapses in at least two instances.

First, a plain reading of ______ Manual should have caused a supervisor to treat the Customer's August 14, 1995 faxed letter as a customer complaint, thereby requiring a referral to the Compliance Department. However, both Respondent and ______ testified that the August 14 letter would not have been treated as a customer complaint pursuant to ______ policy, as implemented by the firm's Compliance Department. Consequently, the Hearing Panel determined that Respondent's failure to view the August 14 letter as a red flag in determining what action to take when the Customer failed to respond to the second activity letter (dated August 17, 1995) was a direct result of ______ interpretation of the phrase "customer complaint."[26]

Second, although ______ Manual stated that branch managers should contact customers who fail to respond to activity letters, the Manual did not provide information as to when and how branch manager contact should be initiated. The firm did not provide guidance or standards to branch managers to assist them in determining when to contact non-responding

[25] See, e.g., District Business Conduct Committee No. 2S v. Merrill Lynch, Pierce, Fenner & Smith, Incorporated, Complaint No. LA-4154, 1989 NASD Discip. LEXIS 33, *8 (NBCC April 26, 1989), which states that a firm's supervisory responsibilities do not end with the drafting of a compliance manual and the transmittal of its manual to the supervisory staff, but require parallel enforcement of supervisory procedures as well.

[26] Current industry standards permit customer complaints to be treated differently based on the classification of the complaint. However, the Hearing Panel believes that ______ Manual, as implemented, established a classification process without adequate guidelines.

customers. The Hearing Panel determined that ______ failure to provide some guidance to its branch managers contributed in part to Respondent's supervisory failures.[27]

C. Extent of Supervisor's Periodic Review and Follow-Up

Although Respondent failed to review ____ posting book and failed to contact the Customer after the second activity letter, the Respondent nevertheless reviewed trading activity in the Customer's account. In fact, Respondent's review caused him to question ____ about the Customer's investment objectives as reflected in the Customer's account documentation. Respondent erred in not adequately following up on the letters from the Customer and in relying too readily on ____ explanations.

Respondent's decision to require ____ to telephone the Customer, after receipt of the first faxed letter on August 9, 1995, although not the best practice, was not so unreasonable as to constitute a failure to supervise. Prior to the receipt of the second faxed letter on August 14, 1995, the Hearing Panel concluded that Respondent had insufficient red flags to warrant further investigation, and Respondent did not act unreasonably in relying on ____ explanations. There were no other customer complaints regarding ____; ____ had not been sanctioned previously by the Association or any other regulatory authority; and the size and the amount of the trades in the Customer account did not indicate any irregularities.

[27] The Hearing Panel notes that the discrepancies between what the firm's policies and procedures required and how those policies and procedures were implemented continued even after the allegations of unauthorized transactions were made in the October 11, 1995 telephone conversation between the Customer and Respondent. The Compliance Department directed Respondent to meet with the Customer before the Compliance Department would take any further action, which was inconsistent with the explicit statement in ______ Manual that all written and verbal customer complaints received at branch offices should be immediately referred to the Compliance Department for review and response.

With respect to the extent of Respondent's inadequacy in his actual supervision, the Hearing Panel viewed Respondent's failure to review the posting book as an aberration. In arriving at this conclusion the Hearing Panel took into consideration the documentation with respect to Respondent's supervisory activities regarding other registered representatives and ______ testimony.

D. Respondent's Supervisory Failures and ____ Misconduct

Although the Customer's losses were significant, the Hearing Panel remains unconvinced that Respondent's supervisory deficiencies permitted ____ to effect the unauthorized trades. It is unlikely that a review of ____ posting book, without the benefit of the subsequent faxed letters, would have led to the discovery of the unauthorized trades. The change in the nature of the stock in the Customer's account from New York Stock Exchange listed securities to securities listed on NASDAQ, without the faxed customer letters, were not sufficient to alert Respondent that there might be a problem with the account. By the time Respondent had sufficient red flags to investigate further, ____ already had effected all of the unauthorized trades in the Customer's account.

E. No Other Mitigating or Aggravating Factors

The Hearing Panel did not consider Respondent's suggestion in 1997 that ______ pay the Customer restitution to be a mitigating factor. In the Hearing Panel's view, the suggestion for restitution was not made promptly. The Hearing Panel did not find any aggravating factors.

Finally, as stated in the introduction to the NASD Sanction Guidelines, the NASD's responsibility is remediation not punishment. The NASD Sanction Guidelines impose remedial sanctions to protect the public from harm by persons who, in light of their misconduct, must be deterred from further misconduct. In the view of the Hearing Panel, a letter of caution is sufficient to influence the future conduct of Respondent.[28]

HEARING PANEL

By: Sharon Witherspoon
Hearing Officer

[28] The Hearing Panel considered all of the arguments of the Parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.