BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X[1] as an Associated Person with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 SD11003 Date: 2011

I. Introduction

On January 26, 2010, the Sponsoring Firm submitted a Membership Continuance Application ("MC-400" or "Application") with the Financial Industry Regulatory Authority's ("FINRA") Department of Registration and Disclosure, seeking to permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as an investment adviser representative. In October 2010, a subcommittee ("Hearing Panel") of FINRA's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, along with the Sponsoring Firm's counsel, Attorney 1, X's Proposed Supervisor, and the Sponsoring Firm's president and chief compliance officer ("President and CCO"). FINRA Employee 1, FINRA Attorney 1, FINRA Attorney 2, FINRA Attorney 3, and FINRA Attorney 4 appeared on behalf of FINRA's Department of Member Regulation ("Member Regulation").

For the reasons explained below, we deny the Sponsoring Firm's Application.[2]

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[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.

[2] Pursuant to FINRA Rule 9524(a)(10), the Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. The Statutory Disqualification Committee considered the Hearing Panel's recommendation and presented a written recommendation to the National Adjudicatory Council ("NAC"), in accordance with FINRA Rule 9524(b)(1).

II. The Statutorily Disqualifying Event

X is statutorily disqualified because he consented to a 2010 Letter of Acceptance, Waiver and Consent ("AWC"), in which FINRA imposed an unqualified bar on him. The AWC found that X improperly withheld a total of $5,150 in investment adviser fees from the Sponsoring Firm from June 2001 through January 2008. The compensation agreement between X and the Sponsoring Firm provided that X would retain 90% of all investment adviser fees received, and the Sponsoring Firm would receive 10%. X received 13 checks totaling $51,500 in investment adviser fees during the relevant period, and deposited the checks into his personal accounts. X did not inform the Sponsoring Firm of these fees, and did not remit 10% to the Sponsoring Firm, until mid-2008 when he confessed to the Sponsoring Firm that he had improperly withheld the funds and repaid the Sponsoring Firm. The AWC found that X violated NASD Rule 2110.

X explained that when he first began improperly withholding fees from the Sponsoring Firm, "I was so far in debt I didn't think I was going to make it. Having $5,000 instead of $4,500 was important at the moment[.]" X further explained that because he considered much of the work that he was doing for the customers in question to be estate planning, tax planning, and insurance related, at the time he felt it was appropriate to retain 100% of these fees. X testified that he came forward and informed the Sponsoring Firm that he had improperly withheld adviser fees in 2008 during a routine SEC examination to "come clean with it."

III. Background Information

A. X

X first registered in the securities industry as an investment company and variable contracts products representative (Series 6) in February 1994, and registered as a general securities representative (Series 7) in May 1995. Since March 1995, X has been associated with the Sponsoring Firm in these registered capacities, as well as an investment adviser representative. X has also sold insurance as a sole proprietor since January 1994.

In January 2010, the Sponsoring Firm filed a Uniform Termination Notice for Securities Industry Registration ("Form U5"). The Form U5 terminated X's association with the Sponsoring Firm as an investment company and variable contracts products representative and general securities representative, but did not terminate X's association with the Sponsoring Firm as an investment adviser representative. X continued to associate with the Sponsoring Firm as an investment adviser representative until the end of 2010. At that time, all of X's 83 customers were transferred to another Sponsoring Firm registered representative, Employee 1. X had previously employed Employee 1 as an administrative assistant in connection with his insurance business.

Since terminating his association with the Sponsoring Firm as an investment adviser representative, X has been focusing on building his insurance business. X works from an office in City 1, State 1. Employee 1 works at the same location in an office adjacent to X's office. Employee 1 occasionally asks X questions concerning the customers that the Sponsoring Firm transferred to her.

Other than the AWC, the record shows no other disciplinary or regulatory proceedings, complaints, or arbitrations against X.

B. The Sponsoring Firm

The Sponsoring Firm is based in City 2, State 1, and it has been a FINRA member since 1966. The Sponsoring Firm has three offices of supervisory jurisdiction, 69 branch offices, and it employs 36 registered principals and 66 registered representatives. The Sponsoring Firm describes its business as "primarily mutual fund retailer, DPPs, investment advisory services, and corporate equity and bonds." The Sponsoring Firm conducts its brokerage and investment advisory business through a single corporate entity.

FINRA conducted the Sponsoring Firm's most recent Financial/Operation examination in 2010. This examination was filed without action.

A Sales Practice and Municipal examination conducted in 2009 resulted in a Letter of Caution ("LOC") for several violations, including: (1) failing to review or maintain websites with the capability of transmitting electronic communications that were utilized by two registered representatives of the Sponsoring Firm; (2) failing to include or require non-restrictive language in a settlement agreement between the Sponsoring Firm and two customers; (3) failing to conduct the calculation necessary to identify producing managers who may be subject to heightened supervision on a rolling, 12-month basis and failing to identify the President and CCO as a producing manager subject to heightened supervision; (4) failing to timely make certain disclosures pursuant to NASD Rule 3070; (5) having written supervisory procedures ("WSP") that did not address how the Sponsoring Firm would ensure compliance with NASD Rule 3070(f) and how the Sponsoring Firm would ensure that email communications relating to its securities business were being maintained; and (6) having an inadequate privacy policy.

FINRA issued the Sponsoring Firm an LOC in connection with a 2007 routine examination for several violations, including: (1) overstating net capital; (2) failing to notify FINRA prior to employing electronic storage media for its books and records; and (3) failing timely to report two customer complaints and a mediation settlement and failing timely to update a registered representative's Uniform Application for Securities Registration or Transfer.

The record shows no other recent disciplinary history, complaints, or arbitrations against the Sponsoring Firm.

IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes to employ X from a non-branch location in City 1, State 1, where he currently operates his insurance business. The Sponsoring Firm proposes that X will act solely as an investment adviser representative (and not in any registered capacity related to the Sponsoring Firm's broker-dealer business), and that X will be compensated with 90% of investment adviser fees received.

The Sponsoring Firm proposes that the Proposed Supervisor will be X's primary supervisor. The Proposed Supervisor will be located at the Sponsoring Firm's main office in City 2, State 1, approximately five miles away from X's office. The Proposed Supervisor currently serves as a vice-president of the Sponsoring Firm. The Proposed Supervisor entered the securities industry in 1980, and is registered as a general securities representative (Series 7), general securities principal (Series 24), investment company products/variable contracts principal (Series 26), and direct participation programs limited principal (Series 39).

In 1996, the Proposed Supervisor was named in a customer complaint that alleged fraud, negligence, failure to supervise, and breach of fiduciary duty. The complaint was settled in arbitration for $78,000. The Proposed Supervisor contributed $2,000 to that settlement.

The record shows no disciplinary history for the Proposed Supervisor.

The Sponsoring Firm has proposed the following plan of heightened supervision:

1. The Sponsoring Firm will amend its WSP to state that the Proposed Supervisor is the primary supervisor for X.

2. X will not act in a supervisory capacity.

3. There will be two unannounced inspections/compliance audits of X's account each year. The inspections will include all of X's personal financial records, including his personal and household bank statements. This will be in addition to the regular compliance audit to which all associated [sic] are subject.

4. X's business will be limited to preparing financial plans providing investment management services using a qualified custodian that reports directly to customers quarterly.

5. X's supervisor will review all proposed investment advisory agreements with any new clients before the agreement is accepted and send a letter to all new clients explaining the relationship between X and the Sponsoring Firm, and explain that all fees must be paid to the Sponsoring Firm.

6. The Sponsoring Firm will send an annual notification to all X's existing clients informing them that the Sponsoring Firm is their registered investment advisor and that X is its representative. The letter will also expressly notify the client that all payments for services that are not automatically paid to the Sponsoring Firm by the custodian of their managed accounts, must be made payable to the Sponsoring Firm.

7. The Sponsoring Firm will periodically call clients on a random basis, and inquire about service improvements and their satisfaction with their fee arrangements, and give them an opportunity to tell the Sponsoring Firm how fees are being paid and if any fees are being paid directly to X rather than to the Sponsoring Firm.

8. If the Proposed Supervisor is absent for any reason, the President and CCO, will be X's supervisor.

9. The Sponsoring Firm will conduct periodic reviews with the custodian of the accounts being managed by X to determine whether all of his clients' records are in the Sponsoring Firm's system. NOTE: The Sponsoring Firm has recently entered into [a] contract with Company 1 for the delivery and implementation of a portfolio management and performance reporting system, and all of the Sponsoring Firm's advisory associates are required to subscribe to and utilize this system for their advisory clients.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because, in its view: (1) X's disqualifying event is serious, securities-related, and recent; (2) the Sponsoring Firm attempts to circumvent the AWC through the statutory disqualification process; (3) the Proposed Supervisor does not appear suitable to supervise X based upon the Proposed Supervisor's other responsibilities at the Sponsoring Firm; and (4) the Sponsoring Firm has "some relevant and recent informal regulatory history."[3]

[3] Member Regulation also argued that X improperly continued to associate with the Sponsoring Firm as an investment adviser representative, despite being barred in all capacities as a result of the AWC, from January 2010 through the end of September 2010. The Sponsoring Firm argued that it believed, upon the advice of counsel and language on FINRA's website, that X could continue to associate with the Sponsoring Firm as an investment adviser representative while the Application was pending notwithstanding the unqualified bar. *See* Statutory Disqualification Process, *available at* www.finra.org/Industry/Enforcement/Adjudication/NAC/StatutoryDisqualificationProcess ("If a person is currently associated with a FINRA member at the time the disqualifying event occurs, however, the person **may be** permitted to continue to work in certain circumstances, **provided** the employer member promptly files a written application seeking permission to continue the employment in an Eligibility Proceeding."). Member Regulation asserted that FINRA Rule 8311 prohibited X from associating with the Sponsoring Firm in any capacity. *See* FINRA Rule 8311 ("If FINRA . . . bars a person from further association with any member, a member shall not allow such person to remain associated with it in any capacity, including a clerical or ministerial capacity."). After numerous discussions with Member Regulation over the course of several months, X ceased all investment adviser representative activities in accordance with Member Regulation's demands.

We find that X should not have associated with the Sponsoring Firm in any capacity, including solely as an investment adviser representative, upon entry of the AWC and pending resolution of the Application. At the hearing, Member Regulation stated that because X was no longer associated with the Sponsoring Firm as of 2010, it was satisfied that X and the Sponsoring Firm were in compliance with the terms of the AWC. Under the circumstances, we have not

[Footnote continued on next page]

VI. Discussion

After carefully considering the entire record in this matter, including the testimony and other evidence submitted at the hearing, we find that X's association with the Sponsoring Firm would pose an unreasonable risk of harm to the market or investors. We therefore deny the Sponsoring Firm's Application to employ X as an associated person.

X is statutorily disqualified due to FINRA imposing on him an unqualified bar—FINRA's most serious sanction—in 2010. We have previously noted, in several earlier statutory disqualification cases involving unqualified FINRA-imposed bars, that "[b]ars are intended to prohibit completely a person's ability to engage in any future securities business with any member firm, thus precluding re-entry into the securities industry absent extremely unusual circumstances." *See The Ass'n of X as a Gen. Secs. Representative*, Redacted Decision No. SD01016, at 4 (NASD NAC 2001), *available at* http://www.finra.org/web/groups/enforcement/documents/nac_stat_dq_decisions/p012616.pdf; *The Ass'n of X as an Inv. Co. & Variable Contracts Products Representative*, Redacted Decision No. SD99023, at 3 (NASD NAC 1999), *available at* http://www.finra.org/web/groups/enforcement/documents/nac_stat_dq_decisions/p011593.pdf. Thus, a FINRA-barred applicant is required to make an extremely strong showing for us to find that approval of an application for re-entry would serve the public interest. *The Ass'n of X as an Inv. Co. &.Variable Contracts Products Representative*, Redacted Decision No. SD99023, at 3.

We find that the Sponsoring Firm has not made the strong showing necessary for our approval of its Application for X to re-enter the securities industry and associate with a FINRA member firm. *See Gershon Tannenbaum*, 50 S.E.C. 1138, 1140 (1992) ("In NASD proceedings . . . the burden rests on the applicant to show that, despite the disqualification, it is in the public interest to permit the requested employment."). FINRA barred X because he, while employed by the Sponsoring Firm, improperly withheld $5,150 in investment adviser fees from the Sponsoring Firm. From 2001 through 2008, X received from customers $51,500 in investment adviser fees, and deposited the funds into his personal accounts without informing the Sponsoring Firm of these fees and remitting 10% to the Sponsoring Firm pursuant to X's compensation agreement. X, who was represented by counsel, agreed to the terms of the AWC imposing an unqualified bar upon him for this misconduct.

X engaged in serious misconduct and FINRA imposed an unqualified bar on him. *See John Saad*, Exchange Act Rel. No. 62178, 2010 SEC LEXIS 1761, at *14, *30 (May 26, 2010) (finding that representative's falsification and submission of expense reports to improperly receive funds from firm were "highly troubling" and "reflect[ed] negatively on both Saad's ability to comply with regulatory requirements and his ability to handle other people's money."), *appeal pending*, No. 10-1195 (D.C. Cir. July 22, 2010). X's misconduct was deceitful, as he

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considered X's continued association with the Sponsoring Firm subsequent to the AWC as a factor in rendering this decision.

intentionally and improperly withheld fees from the Sponsoring Firm and did so for more than six years. *See Frank Kufrovich*, 55 S.E.C. 616, 627 (2002) ("[a] propensity for dishonest behavior is of particular concern in the securities industry, an industry that presents numerous opportunities for abuses of trust.").

Moreover, the AWC is quite recent. The Sponsoring Firm filed the Application just several weeks after acceptance of the AWC in 2010, and X only began complying fully with the AWC in late 2010. *See The Ass'n of X as a Gen. Secs. Representative*, Redacted Decision No. SD08004, at 8 (FINRA NAC 2008), *available at* http://www.finra.org/ web/groups/enforcement/ documents/nac_stat_dq_decisions/p117873.pdf (denying application where less than five years had passed between statutorily disqualified individual's consent to an unqualified FINRA bar and filing of the MC-400). Given the reasons for FINRA's imposition of the bar on X, and the fact that he has previously exhibited an inability to follow securities rules and regulations, we conclude that insufficient time has elapsed for X to demonstrate his willingness or ability to operate responsibly in the securities industry.

At the hearing, X and counsel for the Sponsoring Firm attempted to explain why X agreed to the AWC and argued that we should consider that the party wronged by X's misconduct—the Sponsoring Firm—is now sponsoring X's proposed return to the securities industry. Neither factor, however, is relevant to our determination that X's re-entry into the securities industry would pose an unreasonable risk of harm to the market and investors. X cannot collaterally attack the basis for the AWC, and our determination to reject the Application is independent of the Sponsoring Firm's assessment of the Application's merits. *See Joseph Frymer*, 49 S.E.C. 1181, 1182 (1989) (rejecting applicant's attempt to collaterally attack underlying statutorily disqualifying event); *cf. Maximo Justo Guevara*, 54 S.E.C. 655, 664 (2000) (holding that FINRA's "power to enforce its rules is independent of a customer's decision not to complain"), *pet. for review denied*, 47 F. App'x 198 (3d Cir. 2000). X knowingly and willingly consented to the AWC, which barred him from associating with any FINRA member firm in any capacity. X's argument that the misconduct underlying the AWC did not harm any customers is similarly without merit. *See id*; *cf. Kevin M. Glodek*, Exchange Act Rel. No. 60937, 2009 SEC LEXIS 3936, at *27 (Nov. 4, 2009) ("The fact that many of the customers did not lose money and did not complain about the violations does not further mitigate Glodek's misconduct.").

We also reject the Sponsoring Firm's argument that this case is unique because X voluntarily disclosed his misconduct to the Sponsoring Firm. X testified at the hearing that he confessed to the Sponsoring Firm that he had been improperly withholding investment adviser fees for more than six years only after he became concerned that the SEC would discover his misconduct during its routine examination of the Sponsoring Firm in 2008. And even if X had disclosed his misconduct to the Sponsoring Firm in the absence of an SEC examination of the Sponsoring Firm, such fact does not satisfy the extremely high threshold necessary to permit X to re-enter the securities industry in light of the very recent AWC imposing an unconditional bar.

Finally, we reject the Sponsoring Firm's argument that we should consider that X is seeking to associate with a FINRA member firm not in a capacity related to the Sponsoring Firm's brokerage business, but rather solely as an investment adviser representative. X's

proposed association with a FINRA member firm, even if not in a registered capacity, requires that the Sponsoring Firm demonstrate that despite X's status as a statutorily disqualified individual, it is in the public interest to permit the requested employment. *See* FINRA By-Laws, Article III, Sec. 3(d) ("The Board may, in its discretion, approve the association . . . of any person, if the Board determines that such approval is consistent with the public interest and the protection of investors."); FINRA By-Laws, Article III, Sec. 3(b) ("[n]o person shall become associated with a member . . . if such person is or becomes subject to a disqualification"); *see also Dist. Bus. Conduct Comm. v. Paramount Invs. Int'l, Inc.*, Complaint No. C3A940048, 1995 NASD Discip. LEXIS 248, at *12 (NASD NBCC Oct. 20, 1995) (construing the definition of associated person broadly and finding that firm improperly permitted statutorily disqualified person to associate with it). The Sponsoring Firm has failed to demonstrate that it is in the public interest to permit X to associate with it as a FINRA member firm, and the Sponsoring Firm has not made the requisite strong showing of exceptional circumstances necessary for relief from a recently imposed unqualified bar. Consequently, we deny the Application.[4]

VII. Conclusion

In conclusion, we find that it is not in the public interest, and would create an unreasonable risk of harm to the market or investors, for X to become associated with the Sponsoring Firm as an investment adviser representative. We therefore deny the Application.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith, Senior Vice President
and Corporate Secretary

[4] We further find, based upon testimony at the hearing, that the Sponsoring Firm's proposed plan of heightened supervision fails to adequately ensure that X would not engage in activities related to the Sponsoring Firm's broker-dealer business when engaging in activities as an investment adviser representative. Were we otherwise inclined to approve this Application, which we are not, we would have given the Sponsoring Firm an opportunity to submit a revised plan that addresses these concerns. As we have explained, however, our finding that the Sponsoring Firm has failed to make the strong showing necessary for our approval of its Application in light of the recent unqualified bar warrants, on its own, denial of this Application.