BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Continued Association of X[1] as a General Securities Representative with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 SD11005 Date: 2011

I. Introduction

On December 10, 2009, the Sponsoring Firm filed a Membership Continuance Application ("MC-400" or "the Application") with FINRA's Department of Registration and Disclosure. The Application requests that FINRA permit X, a person subject to a statutory disqualification, to continue to associate with the Sponsoring Firm as a general securities representative. In February 2011, a subcommittee ("Hearing Panel") of FINRA's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, accompanied by his counsel, Attorney 1, and his Proposed Supervisor. FINRA Employee 1, FINRA Attorney 1, FINRA Attorney 2, and FINRA Attorney 3 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.

II. The Statutorily Disqualifying Event

X is statutorily disqualified because of a Consent Order dated November 2004, entered by State 1's Office of Secretary of State (the "State 1 Order") and based upon a petition filed by the State 1 Securities Commission. The State 1 Order prohibited X from applying for securities registration in State 1 for 10 years, fined him $7,500, and ordered him to cease and desist from violating, or materially aiding others in the violation of, State 1 law by making or causing to be made false or misleading statements in filings with State 1.[3] The basis for the State 1 Order was X's failure to timely report a customer complaint on his Uniform Application for Securities Industry Registration or Transfer ("Form U4"). Specifically, in October 2002, X received a customer complaint alleging that he made unsuitable recommendations to a customer, and for which the customer sought compensatory damages of $309,000 (the "October 2002 Complaint"). In September 2003, X's firm ("Firm X") settled the October 2002 Complaint and paid the complaining customer $125,000.

Although X did not contribute to the settlement and the matter was expunged from his record in 2008, X was required to amend timely his Form U4 while at Firm X to reflect the October 2002 Complaint and the settlement. X failed to do so. X further failed to disclose these matters on his Form U4 when he joined another firm ("Firm Y") in January 2004. X finally amended his Form U4 to reflect the October 2002 Complaint and settlement in March 2004.

X testified that he did not know the complaining customer and was named in the October 2002 Complaint along with numerous other individuals. He further testified that the chief compliance officer at Firm X informed him of the complaint and told him not to "worry about it, you don't know the customer, you don't know the broker, you don't—you had nothing to do

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[3] X is statutorily disqualified under Art. III, Section 4 of FINRA's By-Laws, which provides that, "[a] person is subject to a 'disqualification' with respect to . . . association with a member, if such person is subject to any 'statutory disqualification' as such term is defined in Section 3(a)(39) of the [Securities Exchange] Act [of 1934 ("Exchange Act")]." In turn, Section 3(a)(39)(F) of the Exchange Act provides that:

> A person is subject to a 'statutory disqualification' with respect to . . . association with a member of, a self-regulatory organization, if such person—(F) has committed or omitted any act or is subject to an order or finding enumerated in subparagraph . . . (H) . . . of paragraph (4) of section 15(b).

"Section 604 of the Sarbanes-Oxley Act expanded the definition of statutory disqualification in Exchange Act Section 3(a)(39) by creating and incorporating Exchange Act Section 15(b)(4)(H) so as to include persons that are subject to any final order of a state securities commission . . . that . . . constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative or deceptive conduct." *FINRA Regulatory Notice 09-19*, 2009 FINRA LEXIS 52, at *5 (April 2009). Although X and the Sponsoring Firm initially asserted that the State 1 Order did not render X statutorily disqualified, at the hearing counsel for X and the Sponsoring Firm conceded that the State 1 Order is disqualifying.

with it, just don't worry about it." X believed that the chief compliance officer was going to update X's Form U4 to reflect the October 2002 Complaint, but he did not do so. After transferring to Firm Y, X discovered that the October 2002 Complaint had not been reported on his Form U4. X subsequently agreed to the terms of the State 1 Order.

III. Background Information

A. X's Employment and Disciplinary History

X has been employed in the securities industry since 1987. He qualified as a general securities representative (and passed the uniform securities agent state law exam) in January 1988, and qualified as a general securities principal in March 1992. X was previously associated with 11 firms between December 1987 and April 2009. X has been associated with the Sponsoring Firm since April 2009.[4]

In February 1996, a customer alleged that X failed to execute a trade. X's firm settled the claim for $96,735 without X personally contributing to the settlement. X has been the subject of four other complaints, although none of them are publicly disclosable. X is also the subject of several pending arbitration claims filed by former firms.[5]

Other than the State 1 Order and the matters referenced above, the record shows no other criminal, disciplinary or regulatory proceedings, complaints, or arbitrations against X.

B. The Sponsoring Firm

The Sponsoring Firm has been a FINRA member since February 1986. The MC-400 states that the Sponsoring Firm employs 13 registered principals and 41 registered representatives, although the Proposed Supervisor (who serves in several capacities at the Sponsoring Firm, including as its president, chief operating officer, and chief compliance officer) testified that since December 2009, this number has increased to approximately 65 registered persons. The Sponsoring Firm engages in a general securities business, and is based in City 1. The Sponsoring Firm represented on the Application that it has two offices of supervisory jurisdiction ("OSJ") and two branch offices.

In December 2008, FINRA issued the Sponsoring Firm a Letter of Caution ("LOC"). FINRA cited the Sponsoring Firm for the following deficiencies: failing to have adequate

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[4] This is consistent with FINRA's interpretation of Art. III, Sec. 3(c) of FINRA's By-Laws, permitting individuals who become statutorily disqualified while they are employed to continue working pending the outcome of the statutory disqualification process. X became statutorily disqualified effective as of June 2009 because of amendments to FINRA's By-Laws that revised the definition of "disqualification" to conform to the definition set forth in Exchange Act Section 3(a)(39). *See FINRA Regulatory Notice 09-19*, 2009 FINRA LEXIS 52.

[5] *See infra*, note 7.

procedures and timely conduct an audit in connection with its Anti-Money Laundering Compliance Program; failing to accurately report in its books and records certain information; having inadequate control policies and procedures and failing to test its written supervisory procedures ("WSPs") and to establish appropriate procedures regarding internal communications and correspondence; failing to notify FINRA prior to employing an electronic storage medium for maintaining records; having inadequate policies and procedures with respect to safeguarding customer information; failing to provide evidence that copies of Uniform Termination Notices for Securities Industry Registration were provided to two employees; and failing to have an adequate business continuity plan. The Sponsoring Firm undertook remedial action to address these deficiencies.

In April 2008, FINRA accepted a Minor Rule Violation Letter from the Sponsoring Firm. FINRA censured the Sponsoring Firm for filing its annual audit 27 days after it was due.

In December 2005, FINRA issued the Sponsoring Firm an LOC for failing to establish and maintain WSPs in several areas. The Sponsoring Firm undertook remedial action to address these deficiencies.

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

IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes that it will employ X as a general securities representative in its home office in City 1. The Sponsoring Firm represents that X will be compensated by commission.

X will be supervised by the Proposed Supervisor. The Proposed Supervisor first registered as a general securities representative in March 1991, and qualified as a general securities principal in May 1993. The Proposed Supervisor also passed the uniform securities agent state law examination in March 1991. The Proposed Supervisor has been registered with the Sponsoring Firm since July 2005. The Proposed Supervisor serves as the Sponsoring Firm's president, chief operating officer, chief compliance officer, and as the branch manager for the Sponsoring Firm's home office. The Proposed Supervisor also serves as the chief compliance officer for Firm Z, the Sponsoring Firm's investment adviser affiliate. The Proposed Supervisor directly supervises 13 individuals at the Sponsoring Firm. Prior to joining the Sponsoring Firm, the Proposed Supervisor was associated with 13 other firms (three of which he continues to be associated with).

The record shows no criminal, disciplinary or regulatory proceedings, customer complaints, or arbitrations against the Proposed Supervisor.

In the Application, as amended by the Sponsoring Firm, the Sponsoring Firm proposed the following heightened supervisory procedures for X (which we quote in their entirety):

1. The Sponsoring Firm will amend its written supervisory procedures to state that [the Proposed Supervisor] is the primary supervisor responsible for [X];

2. X will not maintain discretionary accounts;

3. X will not act in a supervisory or principal capacity;

4. The Proposed Supervisor will supervise X on-site at the Sponsoring Firm's main office in City 1;

5. X must timely file any necessary disclosures to his Form U4, and in so doing, must report the filing of any such amendments or disclosures directly to the Proposed Supervisor. The Proposed Supervisor must maintain records related to such matters and keep them segregated for ease of review during any statutory disqualification audit;

6. The Proposed Supervisor will review and pre-approve each securities account prior to X's opening the account. The Proposed Supervisor will document the account paperwork as approved with a date and signature and maintain the paperwork at the Sponsoring Firm's home office;

7. The Proposed Supervisor will review and approve X's orders after execution, or as soon as practicable, on a "T+1" basis. The Proposed Supervisor will then review the trade reports, on a T+1 basis, evidence his review by initialing the trade reports, and keep copies of the trade reports segregated for ease of review;

8. X will not be permitted to engage in outside sales activities;

9. The Proposed Supervisor will review X's incoming written correspondence (which would include email communications) immediately upon its arrival and prior to X's receipt and will review and approve outgoing correspondence before they are sent;

10. For the purposes of client communications, X will only be allowed to use an email account that is held at the Sponsoring Firm, with all emails being filtered through the Sponsoring Firm's email system. If X receives a business-related email message in another email account outside the Sponsoring Firm, he will immediately deliver that message to the Sponsoring Firm's email account. X will also inform the Sponsoring Firm of all outside email accounts that he maintains. The Proposed Supervisor will conduct a weekly review of all email messages that are either sent [by] or received by X. The Proposed Supervisor will maintain the emails and keep them segregated for ease of review during any statutory disqualification audit;

11. All complaints pertaining to X, whether verbal or written, will be immediately referred to the Chief Compliance Officer, or his designee. The Compliance Department will prepare a memorandum to the file as to what measures were taken to investigate the merits of the complaint and the resolution of the matter, and will keep documents pertaining to these complaints segregated for ease of review. The CCO will make the Proposed Supervisor aware of any and all complaints against X;

12. If [the Proposed Supervisor] is on vacation or out of the office, Firm Employee 1 will act as X's interim supervisor;[6]

13. For the duration of X's statutory disqualification, the Sponsoring Firm must obtain prior approval (or subsequent approval, if warranted) from Member Regulation if it wishes to change X's status or function at the firm or his responsible supervisor from the Proposed Supervisor to another person; and

14. The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st of each year) to the Compliance Department of the Sponsoring Firm that he and X are in compliance with all of the above conditions of heightened supervision to be accorded X.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because, in its view: (1) X's disqualifying event is recent, serious, and raises questions about his ability to comply with securities rules and regulations; (2) the Proposed Supervisor does not appear to have the time to adequately supervise X given his duties at the Sponsoring Firm and his numerous other professional responsibilities; and (3) X was the subject of numerous customer complaints and several claims by former firms concerning his alleged failure to pay monies owed.

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[6] Firm Employee 1 has been employed in the securities industry since 1987. [He] [q]ualified as a general securities principal (Series 24) in 1995. Firm Employee 1 had a customer complaint filed against him in September 1999 alleging a failure to execute a trade. The claim settled through arbitration. Firm Employee 1 had a customer complaint filed against him in September 1997 alleging unauthorized trading. The claim settled through arbitration.

VI. Discussion

In evaluating an application like this, we assess whether the sponsoring firm has demonstrated that the proposed association of the statutorily disqualified individual is in the public interest and does not create an unreasonable risk of harm to the market or investors. *See Continued Ass'n of X*, Redacted Decision No. SD06003, slip op. at 5 (NASD NAC 2006), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/nacdecisions/p036480.pdf; *see also Frank Kufrovich*, 55 S.E.C. 616, 624 (2002) (holding that FINRA "may deny an application by a firm for association with a statutorily-disqualified individual if it determines that employment under the proposed plan would not be consistent with the public interest and the protection of investors"); FINRA By-Laws, Art. III, Sec. 3(d) (providing that FINRA may approve association of statutorily disqualified person if such approval is consistent with the public interest and the protection of investors). Factors that bear on our assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, the totality of the regulatory and criminal history, and the potential for future regulatory problems. We also consider whether the sponsoring firm has demonstrated that it understands the need for, and has the capability to provide, adequate supervision over the statutorily disqualified person. The sponsoring firm has the burden of demonstrating that the proposed association is in the public interest despite the disqualification. *See Timothy P. Pedregon, Jr.*, Exchange Act Rel. No. 61791, 2010 SEC LEXIS 1164, at *16 & n.17 (Mar. 26, 2010).

After carefully reviewing the entire record in this matter, we find that X's proposed continued association with the Sponsoring Firm would create an unreasonable risk of harm to investors and the market. Accordingly, we deny the Application for X to continue to associate with the Sponsoring Firm as a general securities representative.

We find that X's disqualifying event is serious. X failed to disclose the October 2002 Complaint (which alleged unsuitable recommendations and sought substantial damages), and settlement of the complaint, on his Form U4 while at Firm X. X only disclosed these matters in March 2004, more than 15 months after the October 2002 Complaint was filed. *See* Article V, Section 2(c) of FINRA's By-Laws (requiring that an associated person keep his Form U4 current at all times and amend the form within 30 days after learning of facts or circumstances giving rise to the amendment). Although X explained that he inaccurately believed that the chief compliance officer at Firm X had timely updated his Form U4, X had the obligation to ensure the accuracy of the information on his Form U4. *See, e.g.*, *Robert E. Kauffman*, 51 S.E.C. 838, 840 (1993), *aff'd*, 40 F.3d 1240 (3d Cir. 1994) (table) ("Every person submitting registration documents [to FINRA] has the obligation to ensure that the information printed therein is true and accurate."). As we have stated, FINRA and state regulators rely upon the accuracy of a registered representative's Form U4 to monitor the representative's fitness to participate in the securities industry, and "the candor and forthrightness of the individuals making these Forms U4 is critical to the effectiveness of this screening process." *See Dep't of Enforcement v. Kraemer*, Complaint No. 2006006192901, 2009 FINRA Discip. LEXIS 39, at *12 (FINRA NAC Dec. 18, 2009). X's failure to ensure that his Form U4 was updated in a timely manner raises significant questions concerning X's ability to comply with securities rules and regulations.

We also find that the Sponsoring Firm has failed to demonstrate that it could effectively supervise a statutorily disqualified individual such as X. While we note the lack of disciplinary history for the Proposed Supervisor, he currently supervises directly 13 registered individuals at the Sponsoring Firm, and serves as the Sponsoring Firm's president, chief operating officer, chief compliance officer, and branch manager for the Sponsoring Firm's home office. The Proposed Supervisor also serves as the chief compliance officer for the Sponsoring Firm's investment adviser affiliate, and serves in several other capacities for two other non-FINRA member firms.[7] In total, the Proposed Supervisor spends more than 60 hours per month on these non-Firm related entities, in addition to his numerous responsibilities at the Sponsoring Firm and his overall compliance responsibilities for the entire Sponsoring Firm as its chief compliance officer. Under the circumstances, we conclude that the Proposed Supervisor has insufficient time to devote to the heightened supervision of a statutorily disqualified individual such as X. *See Timothy H. Emerson, Jr.*, Exchange Act Rel. No. 60328, 2009 SEC LEXIS 2417, at *18-19 (July 17, 2009) (finding that FINRA reasonably questioned whether proposed supervisor had sufficient time to supervise statutorily disqualified individual when he already supervised nine other individuals). Further, the proximity of X's desk to the Proposed Supervisor's office does not, by itself, alleviate our concerns that the Proposed Supervisor's numerous responsibilities at the Sponsoring Firm and with non-Firm entities will prevent him from adequately supervising X as a statutorily disqualified individual.

For these reasons, we conclude that the Sponsoring Firm and the Proposed Supervisor are unable to assure us that they will effectively prevent and detect possible misconduct on the part of X.[8]

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[7] The Proposed Supervisor testified that he spends approximately 40 hours per month in his capacity as chief compliance officer for the investment adviser, and the Proposed Supervisor's Central Registration Depository ("CRD"®) report indicates that he spends an additional 20 "non-market" hours per month in this capacity. The Proposed Supervisor also testified that he spends several additional hours per month on two other non-FINRA member entities.

[8] Member Regulation also argues that the Application should be denied because X has been the subject of numerous customer complaints, is currently defending two claims in arbitration filed by former firms seeking repayment of funds, and X's CRD report lists what appears to be a claim by a former firm that went out of business in 1989 regarding the overpayment of commissions to X. As stated above, we find that the seriousness of X's disqualifying event and the Proposed Supervisor's inability to adequately supervise X based upon his numerous other responsibilities warrant denial of this Application. We thus need not consider the customer complaints and other claims filed against X in denying the Application.

VII. Conclusion

Accordingly, 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 continue to associate with the Sponsoring Firm as a general securities 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