

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of the Association

of

X

as a

General Securities Principal

with

The Sponsoring Firm

REDACTED DECISION

Notice Pursuant to
Section 19(d)
Securities Exchange Act
of 1934

Decision No. SD01018

On February 20, 2001, the Sponsoring Firm¹ (or "the Firm") completed an MC-400 application ("the Application") to permit X, a statutorily disqualified person, to associate with the Firm as a general securities principal. In July 2001, a subcommittee ("Hearing Panel") of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by the Proposed Supervisor and the Firm's attorney.

As discussed below, we disapprove the Sponsoring Firm's Application because both the Firm and X have disciplinary histories that stand in conflict with the high regulatory standards that we demand when we approve applications involving statutorily disqualified individuals.

X's Statutory Disqualification

X is subject to a statutory disqualification as a result of his consent to a Judgment of Permanent Injunction in a U.S. District Court for State 1 in 1972. He also is subject to a disqualification as a result of a related Securities and Exchange Commission ("SEC" or "Commission") administrative proceeding. In an order dated 1975, the SEC barred X from

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.

association with any broker-dealer, investment advisor, or investment company with the proviso that he may apply, after 18 months from the date of the SEC's order, to become associated in a non-supervisory and non-proprietary capacity and, after three and one-half years from the date of the SEC's order, in a supervisory or proprietary capacity.

The SEC found that during a ten-day period in 1972, X, who was secretary and director of Firm 1, willfully aided and abetted violations of Section 15(c)(3) of the Securities Exchange Act of 1934 and Rule 15c3-1 thereunder. The SEC found that Firm 1 effected transactions when its aggregate indebtedness exceeded 2,000 percent of its net capital and when it did not maintain net capital of at least \$5,000.

X's Securities Background

X entered the securities industry in 1964. He remained employed in the securities industry until 1973. As described above, in 1975 the SEC barred X and he remained out of the industry for the next four years.

In 1979, Firm 2 applied to the New York Stock Exchange ("NYSE") for permission to employ X as a registered representative subject to a statutory disqualification. The NYSE approved Firm 2's application in 1980 and the SEC approved it in June 1980. Since 1980, X has been approved as a general securities representative pursuant to SEC Rule 19h-1(a)(3)(ii)² with six NASD member firms. X is presently associated with the Sponsoring Firm as a general securities representative.

X's Disciplinary History

In 1973, the NASD accepted X's Letter of Acceptance, Waiver and Consent ("AWC"), which censured and fined him \$2,000 for engaging in the same misconduct that was the basis for his permanent injunction and his SEC bar. X's registration was revoked for the non-payment of this fine in 1974. X paid his fine and costs to the NASD in 1980, and was reinstated.

In 1986, X consented to an SEC offer of settlement that found that he violated Section 5 of the Securities Act of 1933. The SEC ordered him suspended for 60 days from association with any broker, dealer, investment adviser, investment company, municipal securities broker, or municipal securities dealer. The SEC order found that X, who was employed at the time as a registered

². SEC Rule 19h-1(a)(3)(ii) provides that a self-regulatory organization can approve a firm's application to employ a statutorily disqualified individual if the individual has been previously approved by the SEC and the terms and conditions of the new employment are materially the same as the previous employment.

representative, sold unregistered Company 1 common stock in 1983 in violation of the registration provisions of the Securities Act of 1933.

In 2000, a District Director issued X a Letter of Caution regarding his possible association with the Sponsoring Firm in 1999 and 2000 before he was approved for such association as a statutorily disqualified person. The Letter of Caution stated that X assisted the Sponsoring Firm's branch manager in setting up a State 2 branch office, and that he maintained a presence at the office on a regular basis.

The Firm

The Sponsoring Firm became a member of the Association in 1984. The Sponsoring Firm has two offices of supervisory jurisdiction and five branch offices. The Firm employs 503 registered persons, including 81 registered principals and 481 registered representatives. It is a full service brokerage firm and clears its transactions through Firm 3 on a fully disclosed basis.

The Sponsoring Firm's Disciplinary History

In the last four years, the Sponsoring Firm has been the subject of numerous disciplinary actions. In 1997, the Sponsoring Firm agreed to an AWC in which the Firm was fined \$100 for a violation of NASD Rule 6130(d)(6). In the AWC, NASD Regulation found that the Firm executed one short sale transaction in a Nasdaq National Market System security without identifying the transaction as a short sale in its Automated Confirmation Transaction service ("ACT") reporting.

In 1997, the Sponsoring Firm agreed to an AWC in which the Firm was censured and fined \$6,500 for violations of NASD Rule 1020 and MSRB Rule G-37. In the AWC, NASD Regulation found that the Sponsoring Firm failed to file a Form G-37 within 30 days after the end of the quarter, failed to prepare a record of its municipal finance professionals and their political contributions, and failed to register an associated person of the Firm as a principal.

In 1998, the State 3 Securities Division issued a summary order suspending the Firm for failing to supervise its agents properly. In 1998, the administrative petition was withdrawn and dismissed with prejudice after the parties negotiated a resolution of the issues raised in the proceeding.

In 1998, the Sponsoring Firm agreed to an AWC in which it was censured, fined \$31,000, and ordered to provide restitution and interest to two customers in the amounts of \$8,893.76 and \$723.86 for violations of NASD Rules 2110, 2320, 3110, 3010, and SEC Rules 17a-3 and 17a-4. In the AWC, NASD Regulation found that the Firm: (1) violated the best execution rule in 36 instances when it failed to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant price to the customer was as favorable as

possible under the prevailing market conditions; (2) violated the books and records rule when it failed to document the time of order entry on the order ticket in three instances; failed to document the correct execution time on the order ticket in 12 instances; failed to document the time of execution on the order ticket in 11 instances, and failed to maintain a memorandum of two brokerage orders; and (3) violated the supervision rule when it failed to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the ACT rules, the SEC order execution rules, the SOES rules, and the trade reporting rules.

In 1999, NASD Regulation issued the Firm a Letter of Caution for several different aspects of its written supervisory procedures. The Sponsoring Firm responded to this letter by certifying that it had updated its written supervisory procedures to address the areas identified.

In 1999, the Sponsoring Firm entered into a consent agreement with the Division of Securities of State 4's Department of Banking and was fined \$30,000. The State 4 Department of Banking alleged that the Sponsoring Firm employed unregistered agents in the state in violation of State 4 law and failed to establish, enforce, and maintain a system for supervising the activities of the Firm's agents that was reasonably designed to achieve compliance with applicable securities laws and regulations so as to prevent the use of misleading sales material and unregistered agent activity.

In 1999, the Sponsoring Firm agreed to an AWC in which the Firm was fined \$2,000 for violating SEC Rule 11Ac1-1(c). In the AWC, NASD Regulation found that the Firm violated the SEC's order handling rules by entering priced orders into SelectNet broadcasts that were priced better than the Firm's public quote without reflecting each such order in the Firm's public quote.

In 1999, the State 5 Securities Division entered an order against the Firm for violation of the State 5 Securities Act in that the Firm failed to supervise reasonably the securities-related activities of its employees. The State 5 Securities Division ordered the Firm to pay \$1,500 in costs and ordered it to revise its supervisory procedures to prevent high concentration of one type of security in a customer's account.

In 2000, the Sponsoring Firm agreed to an AWC in which it was fined \$2,000 for violation of NASD Rule 4613. In the AWC, NASD Regulation found that on 10 occasions the Firm entered bid or asked quotations that caused a locked market.

The Sponsoring Firm currently employs one individual in the Firm's State 6 office who is subject to a statutory disqualification. NASD Regulation approved the Firm's application to employ Employee 1 in an SEC Rule 19h-1 notice dated 1997.

The Sponsoring Firm's Proposal To Employ X as a General Securities Principal

Currently, X works in the Sponsoring Firm's State 2 office as a general securities representative. The Sponsoring Firm's State 2 office operates as a trading desk with 11 traders and one trading desk supervisor.³ The trading desk makes markets in approximately 800 stocks and executes transactions for institutional customers. The State 2 office executes trades for retail customers of the Firm only in stocks in which the Firm is a market maker. Orders from the Firm's retail customers for stocks in which the Firm does not make a market are routed to other market-making firms. In his current capacity as a general securities representative, X fills in for traders when they are absent from their desks and he assists his son, who is one of the Firm's traders. NASD Regulation approved of X's current employment arrangement in 2000. X is currently supervised by the Proposed Supervisor.

The Sponsoring Firm proposes that X's duties be expanded to include training of the 11 traders in the office in modifications and upgrades to the trading system that the Firm uses. As discussed below, the NASD's rule regarding registration of principals requires that a person who trains associated persons in the conduct of a securities business must be registered as a principal.

The Sponsoring Firm proposes that the Proposed Supervisor, the trading desk supervisor, will be responsible for direct supervision of X. The Proposed Supervisor, like X, is employed at the Sponsoring Firm's State 2 office. The Proposed Supervisor has been registered as a general securities representative since 1985, a general securities principal since February 1987, and an equity trader since 1999. The Proposed Supervisor has no disciplinary or regulatory history.

Member Regulation reviewed this Application and recommends that we approve the Firm's request to employ X as a general securities principal.

Discussion

After careful review of the entire record in this matter, we deny the Sponsoring Firm's Application to employ X as a general securities principal. As discussed below, we base our decision on the disciplinary histories of both X and the Sponsoring Firm.

At the hearing in this matter, the Applicant and Member Regulation agreed that the NASD's Rule regarding registration as a principal requires this MC-400 application. NASD Rule 1021(b) provides that: "Persons associated with a member . . . who are actively engaged in the management of the member's investment banking or securities business, including supervision, solicitation, conduct of business or *the training of persons associated with a member* for any of these

³ The State 2 office also transacts a limited amount of retail business. The office has one general securities representative who has a group of retail customers.

functions are designated as principals." (italics added). Because the Firm proposes to have X train associated persons in the conduct of the Sponsoring Firm's business, we agree that the Firm must submit this Application in order to comply with the registration requirements for principals.

Legal Standard When the SEC Bars a Registered Person with a Right To Reapply

Because the SEC barred X with a right to reapply as a principal after three and one-half years, we consider this case under the guidance provided by the Commission in 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.

In this case, we consider all of X's intervening misconduct since 1975 because we have never approved X to act in any principal capacity. X's 1986 settlement with the SEC resulted in a 60-day suspension from the securities industry for selling unregistered stock. Given that X was employed as a general securities representative in 1983 under a heightened supervisory system because of his statutory disqualification, we find that X's unregistered securities violation demonstrates his failure to achieve the central goal of the statutory disqualification process: Preventing any further violations of the securities laws by the statutorily disqualified individual.

In addition, we are troubled by X's conduct in 1999 and 2000 that led the District Director to issue X a Letter of Caution. The Letter of Caution stated that in 1999, the Sponsoring Firm started building a State 2 office. NASD Regulation did not approve X's association with the Firm until October 2000. At the statutory disqualification hearing, X stated that after the office had opened near the end of 1999, he had visited the office more than five or six times in order to visit with his son or the office manager, who was a personal friend of his. Under questioning from the Hearing Panel, X admitted that he had exercised bad judgment during this episode.

We disapprove of X's conduct during this episode because we expect statutorily disqualified individuals to be vigilant in avoiding conduct that may violate any securities laws or rules. X's conduct fell far short of our expectation.

Turning to the Firm's proposal to have X train the Firm's traders, we place a premium value on the importance of this kind of training. As a trainer of the Firm's traders, X would have the ability to influence the Firm's entire trading operations. Because of the importance of the training function, we take very seriously X's intervening misconduct when evaluating whether to approve the Application.

As to the disciplinary history of the Firm, we hold an unfavorable view of both the Firm's high number of violations and the violations relating to market-making activities. We find that three violations within the last three years relate to the Firm's market-making activities. Specifically, the AWC in 2000 involving the Sponsoring Firm causing locked markets, the AWC in 1999 involving violations of the SEC's order handling rules, and the AWC in 1998 involving failing to maintain written supervisory procedures for SOES rules and trade reporting rules all relate to market making. Because the Firm proposes to assign X to train its traders, we are highly sensitive to the Firm's recent and numerous violations in the market-making area. Furthermore, we find the Firm's disciplinary history far too extensive to warrant our approval of this Application.⁴

Under the Van Dusen analysis, we disapprove this Application based on two factors. First, after being barred from the securities industry, X committed an additional violation of the securities laws. Second, the Sponsoring Firm's many regulatory violations in the last four years, several of which involve market making, indicate that the Firm does not have the level of regulatory compliance, generally and in the trading area, to merit our approval to employ a statutorily disqualified person as a principal who will train traders.⁵

Accordingly, we deny the Sponsoring Firm's Application to employ X as a general securities principal. We find that our denial is in the public interest and serves the goal of investor protection.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

⁴. We note that the Firm's selection of JD as the proposed supervisor for X would be acceptable to us. The disciplinary histories of X and the Firm, however, make irrelevant the issue of a satisfactory supervisor for X.

⁵. The Sponsoring Firm's proposed supervisory plan for X is contained in the record.