

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Continued Association of

X
as a

General Securities Representative; General
Securities Principal; Investment Company/
Variable Contracts Representative; and
Investment Company/Variable Contracts
Principal

with

The Sponsoring Firm

Redacted Decision

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

Decision No. SD04014

Date: 2004

INTRODUCTION

On July 30, 2002, the Sponsoring Firm¹ ("the Firm") completed a Membership Continuance Application ("MC-400" or "the Application") seeking to permit X, a person alleged to be subject to a statutory disqualification, to continue to associate with the Sponsoring Firm as a general securities representative, general securities principal, investment company/variable contracts representative, and investment company/variable contracts principal. In January 2004, a subcommittee ("Hearing Panel") of NASD's Statutory Disqualification Committee held a hearing on the matter. X appeared in person at the hearing, accompanied by his counsel, and his Proposed Supervisor, President of the Sponsoring Firm. LL appeared on behalf of NASD's Department of Member Regulation ("Member Regulation"). Subsequent to the hearing, the Hearing Panel ordered the parties to submit briefs on the issue of whether X meets the definition of disqualification under NASD's By-Laws. After carefully reviewing those briefs and the complete record in this matter, we conclude that X is not statutorily disqualified for the reasons set forth below.

A. X's Alleged Statutorily Disqualifying Event

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.

Member Regulation contends that X is statutorily disqualified because in January 1998, he entered into a settlement with the Commodity Futures Trading Commission ("CFTC"). The CFTC found that X failed to furnish customers with transaction statements reflecting financial results for offsetting equal and opposite trades, and failed to supervise and detect trading irregularities in the handling of his firm's account. The CFTC issued an Opinion and Order Making Findings and Imposing Remedial Sanctions ("CFTC Order") in January 1998 that ordered X "to withdraw his association as an AP (associated person) and not to apply for registration as an AP except as an AP of an IB (introducing broker), and to not act in any capacity as a principal, AP, or an agent or officer of any person and/or entity registered or required to be registered as an FCM (futures commission merchant)."²

B. Background Information

X

X has been employed in the financial and securities industries since 1983. He became a general securities representative in August 1987, a general securities principal in February 1990, and an equity trader in December 1999. NASD granted X an official waiver in January 1984 of the investment company/variable contracts representative and principal qualification examinations.

X was associated as an AP with Firm 1, which was operating as an FCM at the time of the activities that gave rise to the alleged statutorily disqualifying event.

C. Discussion

The Sponsoring Firm has argued that it should not have been required to submit an MC-400 application for X to undergo NASD eligibility proceedings. In a letter dated June 2002, NASD first informed X that he was subject to a statutory disqualification. In a response dated June 2002, the Proposed Supervisor, on behalf of the Sponsoring Firm, asserted that the CFTC Order did not render X statutorily disqualified, and that therefore it was not appropriate to require the Firm to file an MC-400 application for X to undergo an eligibility proceeding. Member Regulation required that the Firm promptly submit an MC-400 application or NASD would revoke X's registrations without further notice. The Firm submitted its Application in July 2002, but maintained that X was not subject to a statutory disqualification. Accordingly, this issue is before us for decision.

1. Statutory Provisions

In order to determine X's statutory disqualification status, we first turn to

² A commodities IB is similar to a securities introducing broker, while an FCM is similar to a securities clearing broker.

the language of the controlling statutory provisions and NASD's By-Laws.

The Securities Exchange Act of 1934 ("the Exchange Act") Section 3(a)(39) states that:

A person is subject to a "statutory disqualification" with respect to membership, or participation in, or association with a member of a self-regulatory organization, if such person:

B. is subject to –

ii. an order of the Commodities Futures Trading Commission denying, suspending, or revoking his registration under the Commodity Exchange Act (7 U.S.C. 1 et seq.)

Art. III, Sec. 4 of NASD's By-Laws provides that:

A person is subject to a "disqualification" with respect to membership, or Association with a member, if such person

(b) is subject to –

(2) an order of the Commodity Futures Trading Commission denying, suspending, or revoking such person's registration under the Commodity Exchange Act (7 U.S.C. 1 et seq.)³

³ Section 3(a)(39) of the Exchange Act and Art. III, Sec. 4 of NASD's By-Laws were amended through the Insider Trading Sanctions Act of 1984, P.L. 98-376, to expand the statutory disqualification provisions to include any person who is subject to a CFTC order denying, suspending, or revoking such person's registration under the Commodity Exchange Act ("CEA"). In interpreting a statute, the SEC and NASD must presume that the "legislature says in a statute what it means and means in a statute what it says." See, e.g., Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 253 (1992). Further, a basic principle of statutory construction provides that words in a statute that are not defined must be given their ordinary meaning. See, e.g., U.S. v. Granderson, 511 U.S. 39, 70 (1994).

The CFTC has comparable authority to exclude statutorily disqualified persons from the industry. Section 8a(3)(J) of the CEA states:

The Commission is authorized –

(3) to refuse to register, or to register conditionally any person, if it is found, after opportunity for hearing, that –

(J) such person is subject to an outstanding order denying, suspending, or expelling such person from membership in a registered entity, a registered futures association, any other self-regulatory organization, or any foreign regulatory program or barring or suspending such person from being associated with any member or members of such registered entity, association, self-regulatory organization, or foreign regulatory body.

1. The CFTC Order

In January 1998, the CFTC Order was entered In the Matter of Techno Trading, Inc., et al. and In the Matter of FSI Futures, Inc., et al. X agreed in the CFTC Order "to withdraw his association as an AP and not to apply for registration as an AP except as an AP of an IB, and to not act in any capacity as a principal, AP, or an agent or officer of any person and/or entity registered or required to be registered as an FCM."

The CFTC Order did not revoke X's registration⁴ or prohibit him from being registered in any category pursuant to the CEA. Rather, it expressly permitted X to be registered as an AP of an IB, and did not exclude him from being registered in many other capacities, such as floor broker, floor trader, commodity trading advisor, and commodity pool operator. In fact, X continued to be registered with the CFTC, with the full knowledge and assistance of the National Futures Association ("NFA").

2. X Is Not Statutorily Disqualified Under the CEA and Therefore Is Not Statutorily Disqualified Under NASD's Rules

The CEA establishes a standard of statutory disqualification pursuant to which the CFTC may refuse to register persons subject to an order denying, suspending, or expelling such person from registration with a member. The CEA's statutory disqualification standard is similar to that established by NASD.

⁴ The CFTC Order did specifically revoke the registrations of two other individuals and two entities. Thus, the CFTC agreed to treat X differently by not issuing a revocation order against him.

Specifically, Section 8a(3)(J) of the CEA states that a person is statutorily disqualified if he or she is subject to an "order denying, suspending, or expelling such person from membership." Similarly, Section 3(a)(39) of the Exchange Act and Art. III, Sec. 4 of NASD's By-Laws state that a person is statutorily disqualified if he or she is subject to a CFTC "order denying, suspending, or revoking such person's registration." Accordingly, giving regulatory comity to the CFTC, we conclude that if a CFTC order is not a statutory disqualification under the CEA, it is not a statutory disqualification pursuant to the Exchange Act or NASD's By-Laws.

In a fully litigated proceeding in 1992, the CFTC addressed the issue of whether a person is disqualified if he or she has agreed to a settlement in which he or she is ordered to comply with an undertaking to withdraw a registration and not reapply. See Leslie T. Peterson v. Nat'l Futures Ass'n, 1992 CFTC LEXIS 416 (Oct. 7, 1992). In this case, the applicant, Leslie T. Peterson ("Peterson") settled a disciplinary action with the New York Mercantile Exchange ("NYMEX") in 1984 and agreed to undertake to withdraw his membership from NYMEX and never reapply. Five years later, in 1989, Peterson applied for registration as an AP with the NFA. Based on the 1984 ordered undertaking, the NFA commenced a statutory disqualification proceeding against Peterson and denied his application. Peterson appealed to the CFTC.

The CFTC found that Peterson Employee 1 was not statutorily disqualified under the CEA because the language of his settlement did not fit within the language of Section 8a(3)(J), which provides that a person is statutorily disqualified if he or she is subject to an "order denying, suspending, or expelling such person from membership." The CFTC reasoned that the CEA's statutory language served notice to individuals of the specific grounds for disqualifications. Therefore, the CFTC stated that the NFA could not interpret the statute in such a way as to eliminate the distinctions reflected in the language that Congress adopted. The CFTC concluded that because the disqualifying statute did not include appropriate language to encompass an undertaking to withdraw from membership, Peterson could not have been on notice that the language of Section 8a(3)(J), which included the words "deny, suspend and expel," would also include the wording of his order to comply with an "undertaking to withdraw and never reapply."

The CFTC also stated that in order to give effect to the terms to which the parties had agreed, Peterson's settlement had to be construed as written and "not as it might have been written had the allegations of the complaint been established through adjudication." Peterson, 1992 CFTC LEXIS 416 at *9-10, citing U.S. v. ITT Continental Baking Co., 420 U.S. 223, 236-37 (1975). Accordingly, the CFTC found that the NFA could not unilaterally rewrite the parties' agreement to create an order that met the "denying, suspending and expelling" requirements of Section 8a(3)(J).⁵

⁵ We have given deference to determinations by the CFTC in the past. In NASD Statutory Disqualification Decision SD00003, we stated that NASD would effectively frustrate the remedial purposes underlying CFTC orders by independently redetermining the availability of registrations that had already been determined by the CFTC. In deferring to the CFTC's determination that Mr. X should not be registered in the commodities industry for three years, we

[Footnote continued on next page]

Here, X is in a position similar to Employee 1 on the question of whether an ordered undertaking to withdraw and not reapply amounts to a statutory disqualification. In fact, the specific language of X's CFTC Order makes this determination even easier. While Employee 1 was ordered to undertake to withdraw his NYMEX registration in all categories and never reapply, X's settlement language provides only that he undertake to withdraw his registration as an AP of an FCM and never reapply for registration as such. The CFTC expressly permitted X to be registered as an AP of an IB, and did not prohibit him from registering in numerous other categories – such as floor broker, floor trader, commodity trading advisor, and commodity pool operator. Thus, we find that the CFTC Order did not operate as a statutory disqualification for X.

Moreover, the CFTC itself did not consider its order against X to be a statutorily disqualifying event. The record shows that X has remained continually registered with the CFTC since the entry of the CFTC Order, without having undergone statutory disqualification proceedings pursuant to Sections 8a(2)(A) and (F) of the CEA. In January 1998, pursuant to the CFTC Order, FSI and X filed required forms with the NFA to withdraw FSI's registration as an FCM and register instead as an IB. In April 1996, the NFA granted FSI's registration as an IB and terminated its registration as an FCM. With the permission of the NFA, X's registration as an AP and principal of an FCM was converted into an AP and principal of an IB, without his registration being revoked or withdrawn. X therefore continued to be registered under the CEA with FSI, until its voluntary withdrawal in January 2002. The CFTC never utilized its regulatory disqualification process against X.

Our conclusion that X is not statutorily disqualified is consistent with our previous decisions. NASD has not required a person who is barred in a single registered capacity (such as a general securities principal), but registered in other capacities (such as a general securities representative), to undergo NASD's eligibility proceedings in order to remain associated with a member firm in the allowed category.

Accordingly, we conclude that the CFTC Order here does not create a statutory disqualification for X and therefore he may maintain his securities registrations with the Sponsoring Firm.

On Behalf of the National Adjudicatory Council,

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concluded that Mr. X should not be employed in the securities industry during the three-year period of the undertaking. We also recognize that in SD00003 we treated the individual's CFTC settlement as a statutory disqualification; however, in that case, the CFTC had ordered that Mr. X should withdraw his registration and not reapply for three years in all categories. In such a situation, NASD is more able to construe the CFTC order as representing a bar with the right to reapply in three years, or a suspension for three years.

Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary