

This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C01010003.

_____, Inc. (“the Firm”), acting through Respondent _____ (“_____”), conducted business, provided supervision, and prepared and filed reports pursuant to SEC Rule 17a-5, which were signed by _____ in his capacity as Principal of the Firm, while _____ was not registered with the Firm as a principal or in any other capacity. The Complaint also alleges that _____ was actively engaged in the management of the Firm’s investment banking or securities business while he was not registered with the firm as a principal or in any other capacity. On July 10, 2001, _____ and the Firm filed an Answer, denying that they engaged in investment banking, admitting that a technical violation occurred, and asserting that no harm came to the public, the Firm’s clients, or the NASDR. A hearing was held in San Francisco, California, on November 16, 2001, before a panel composed of the Hearing Officer and one current and one former member of District Committee No. 1.

Findings of Fact

The parties have stipulated to the facts which follow. All exhibits proffered by the parties were admitted into evidence without objection. Additional facts, which come from the hearing testimony, are referenced by the transcript page numbers at which they appear. The focus of the hearing concerned the sanctions, if any, that should follow from the violations which were admitted by the Respondents.

The Firm became a member of the NASD on February 26, 1986, and since that time, has continuously conducted a general securities business. Its other businesses include document translation services, insurance, real estate, and fee-based financial planning. In 2001, its gross revenue from all sources was \$132,000. Tr. 59. As a small firm, it was required to have only one principal at all times. Tr. 11. From 1986 until the present, _____ has been the majority

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shareholder of the Firm. His wife, _____, is also a shareholder and an associated person of the Firm, but she is not active in its securities business.

_____ first associated with a member of the NASD in October 1980. From February 26, 1986, until March 4, 1996, he was registered with the Firm, which he founded, as a General Securities Principal and as a General Securities Representative. Neither the Firm nor _____ has any disciplinary history. Sometime in 1987, _____ (“____”) became associated with the Firm as a General Securities Representative. Tr. 13.

In February 1996, _____ decided to move his own securities practice to _____, Inc. (“_____”), to take advantage of certain business opportunities he thought _____ would offer him. Tr. 13. To that end, on February 29, 1996, the Firm filed a Uniform Termination Notice of Securities Industry Registration (Form U-5) on behalf of _____, fully terminating his registration with the Firm. On March 4, 1996, he became registered with _____ as a General Securities Principal and as a General Securities Representative. _____’s registration with _____ ended on December 31, 1997.

While he was registered with _____, and at all times relevant to the Complaint, _____ continued to maintain his physical place of work in the Firm’s offices. While registered with _____, he effected all new securities transactions on behalf of his own clients through _____. He disclosed to _____ his employment as President of the Firm. From February 29, 1996, the date his registration with the Firm was terminated, until May 7, 1996, the date ____ became registered as a principal, the Firm had no registered principal.

After _____ terminated his registration with _____ on December 31, 1997, the Firm, on January 23, 1998, filed a Form U-4 on his behalf. He has been registered as a

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General Securities Principal and as a General Securities Representative with the Firm since that time.

From March 1996 through December 1997, while he was registered with _____ and not with the Firm, _____:

1. did the Firm's day-to-day bookkeeping and wrote checks on its bank account;
2. continued to be solely responsible for ____'s supervision;
3. prepared and filed the Firm's FOCUS reports;
4. filed an Amendment to the Firm's Form BD on its behalf; and
5. received compensation from the Firm, including trail commissions he earned on transactions executed while he was registered with the Firm, and an override on commissions earned by ____.

Discussion

From March 26, 1996, to January 23, 1998, _____, was required to be, but was not in fact, registered as a principal with the Firm. The Firm was required to assure that he was registered as a principal because he was engaged in the management of the Firm's business. NASD Registration Rule 1021 provides that all principals must be registered. That Rule defines Principals as those "who are actively engaged in the management of the member's . . . securities business, including supervision, solicitation, conduct of business, or the training of persons associated with a member for any of these functions." Such persons include "officers" and "directors of corporations" who are actively engaged in management. NASD Notice to Members, 99-49 (1999).

_____ was required to be registered as a principal of the Firm because (1) he supervised ____, (2) he was the President of the Firm and one of its directors, (3) he held himself

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out to be a principal of the Firm when he filed its FOCUS reports and an amendment to its Form BD, and (4) he performed the duties of a Limited Principal – Financial and Operations, by controlling the Firm’s financial records, and by preparing and filing its FOCUS reports. A violation of the registration rule is also a violation of Conduct Rule 2110¹.

Sanctions

For registration violations, the NASD Sanction Guidelines recommend a fine of \$2,500 to \$50,000, and, in the case of an individual, consideration of a suspension for up to six months.² NASD SANCTION GUIDELINES, at 52 (2001 ed.). Enforcement requests that the Firm be fined \$7,500 for its failure to assure that _____ was registered, and that _____ be fined \$7,500 for his failure to maintain his registration at the Firm. In addition, Enforcement requests that _____ be suspended in all principal and supervisory capacities for a period of 30 days. _____ asserts that his firm is a small one, with gross revenues in 2001 of \$132,000; that he committed a series of innocent mistakes that caused no one any harm; and that, therefore, a letter of caution should be sufficient as a sanction.

Enforcement asserts that the violations are serious because: (1) _____ had multiple responsibilities, each of which would require registration if standing alone; (2) the violations continued for a period of almost two years; and (3) the violations were committed recklessly, in that _____ knew he was acting in a principal capacity. On the other hand, Enforcement cites the following factors that should favor leniency: (1) _____ has accepted responsibility for the violations; (2) _____ had passed the Series 24 examination and was qualified for the

¹ *William S. Mentis*, Exch. Act Rel. No. 37952, 1996 SEC LEXIS 3192 at *5 (Nov. 15, 1996).

² In egregious cases, the recommendation is a suspension for up to 30 business days for the firm, and for the individual, a suspension of up to two years or a bar. Enforcement does not suggest, and the Hearing Panel does not find, that this is an egregious case.

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functions he performed; and (3) there is no evidence of other misconduct or injury which resulted from the registration violations.

Compliance with NASD registration requirements is fundamentally important. The National Business Conduct Committee stated:

The requirement that a person . . . must register as a principal when actively engaged in a firm's securities business is an important one. This requirement assists in the policing of the securities markets. It also ensures that a person in a position to exercise some degree of control over a firm has a comprehensive knowledge of the securities industry and its related rules and regulations. This, in turn, enhances investor protection. We deem it essential to the well-being of the investing public that persons engaged in a firm's securities business strictly adhere to the proper registration requirements.

DBCC v. Pecaro, No. C8A960029, 1998 NASD Discip. LEXIS 13, at *22 (NBCC Jan. 7, 1998).

In considering the appropriate sanctions to ensure compliance in this case, the Hearing Panel looked to the first general principal applicable to all sanction determinations. The Sanction Guidelines provide:

Adjudicators should balance the concepts of remediation and deterrence by imposing sanctions that both effectively address the violative conduct and are of sufficient moment to discourage and prevent future violations and to improve overall standards. When applying these principles and crafting appropriately remedial sanctions, Adjudicators should consider firm size with a view toward ensuring that the sanctions imposed are not punitive.

GUIDELINES, at 3.

The Hearing Panel has also considered the arguments of the parties and reviewed the specific considerations in the Guidelines for the violations in determining the appropriate sanctions. In so doing, the Hearing Panel found a number of factors that militate against increasing the fine above the minimum suggested by the Guidelines, or imposing a suspension. In the first place, the Firm is small and derives its income not only from the securities business, but also from _____'s translation services and from other business interests such as real estate and life insurance. The income from all sources was combined into one account, and _____ was the only person who coordinated the income streams and knew how the

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accounting system worked. Tr. 65. Second, _____ was aware of the need to have at least one principal at the firm, and to that end, he encouraged ___ to study for and take the Series 24 examination. ___ passed that examination and became registered with the Firm as a principal. Although there was a short period of time when the Firm was without a principal, the Firm was not actively engaged in new securities transactions. In addition to studying for the examination, ___ was renovating his house and showing it to prospective buyers, packing his household goods, and moving to Spokane, Washington. The income he received during that time was based on prior sales activity and customers' systematic investment plans. Tr. 63.

Third, although _____ acted as a principal of the Firm while he was with _____ and not registered as a principal with the Firm, the Hearing Panel finds that he did not do so recklessly, although he did so negligently. He testified: "I saw myself as somewhat of a 'super bookkeeper' who would compile the reports as before, and submit them. My mistake, I now realize, was that I signed them as a principal when I was registered with _____." Tr. 26. Had he given greater thought to his actions, he would have realized that he did not have to terminate his registration as a principal of the Firm in order to become registered with _____. When he registered with _____, he could have checked the box for dual registration (Item 9) on the Form U-4. There is no proscription against dual registration as a principal. He filed FOCUS reports for the Firm because he was the only one who knew how to file them; he knew that they had to be filed if the Firm were to stay in business and ___ were to continue his employment with it. He testified:

Had I even had a glimmer of the implications of this, I never would have switched over to _____. . . . In a phone call to Mr. Utevsky, he asked why I had not registered with both firms, since it was allowed by NASD and my response was that it never occurred to me to do this. In other words, failure to file a piece of paper is all that would have been required to avoid this entire problem. But for that form, we would not be here today.

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Tr. 66. _____ was not unmindful of his obligation to adhere to NASD conduct rules. For example, in order to ensure that he did not violate the rule prohibiting “selling away”, he effected all new transactions through _____, and none through the Firm.

Finally, this case differs from the cases cited by Enforcement that involved registration requirements where fines have been imposed above the minimum suggested by the Guidelines and where suspensions have been ordered. _____ had qualified and had been serving as a General Securities Principal for 10 years. This is not a case where an individual has never qualified as a principal, but nevertheless acts in that capacity.³ Neither is this a case where an individual has been told by the NASD to qualify as a principal, but fails to heed that admonition.⁴ Nor is this a case where multiple registration and conduct violations are alleged.⁵

On the other hand, because of the nature and extent of _____’s responsibilities with the Firm, and the extended period of time over which the violations occurred, a fine is appropriate in this case. Moreover, separate sanctions for the Firm and for _____ are appropriate because there are two different responsibilities involved. In addition, a fine is necessary to demonstrate that the NASD takes its registration requirements seriously and cannot excuse violations from even the smallest firms.

The Hearing Panel finds that both the Firm and _____ violated NASD Conduct Rule 2110 and Registration Rule 1021. Accordingly, considering both the need for deterrence and a sanction that is remedial, but not punitive, the Hearing Panel fines the Firm \$2,500, fines

³ *Pecaro, supra* (Respondent fined \$7,500, not suspended, but ordered to qualify); cf. *DOE v. W.H. Mell et al.* No. C9B990019 (OHO July 3, 2000) (Respondents fined \$3,000, jointly and severally; no suspension).

⁴ *DOE v. Sturdivant & Co., Inc. et al.*, No. C9A980020 (OHO Jan. 20, 1999)(Respondent took examination only after threat of disciplinary proceedings; Respondent fined \$10,000 and suspended for 60 days).

⁵ *DOE v. Marinovich*, No. CAF990049 (June 14, 2000) (default decision) (Respondent in boiler room operation of member, later expelled from NASD, never applied for principal registration; for registration violation only, Respondent fined \$2,500 and suspended for 20 days).

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_____ \$2,500, and requires _____ to requalify as a General Securities Principal within 90 days of the date this decision becomes the final decision of the NASD, or if he fails to requalify within that time, orders that he be suspended until he so requalifies. The sanctions shall become effective on a date determined by the Association, but not sooner than 30 days from the date this decision becomes the final disciplinary decision of the NASD.

Alan W. Heifetz
Hearing Officer
For the Hearing Panel