



**This Decision has been published by the NASDR Office of Hearing Officers and should be cited as OHO Redacted Decision C9B990019.**

Based on the hearing record, the Hearing Panel found that the Respondents committed the violations as alleged in the Complaint. The Hearing Panel fined the Respondents \$3,000 jointly and severally.

### *Appearances*

Michael J. Newman, Esq., and David B. Klafter, Esq., Woodbridge, NJ, (Rory C. Flynn, Washington, DC, Of Counsel), on behalf of the Department of Enforcement.  
\_\_\_\_\_, Esq. and \_\_\_\_\_, Esq., on behalf of the Respondents.

## **DECISION**

### **I. PROCEDURAL BACKGROUND**

#### **A. Complaint**

Enforcement filed a single cause Complaint on July 26, 1999. The Complaint alleged that from September 1996 through March 5, 1999, \_\_\_\_\_ acted as a General Securities Principal of \_\_\_\_\_ while failing to properly qualify or register prior to serving in that capacity.<sup>1</sup> According to the Complaint, from September 1996 through August 1998, the firm, acting through \_\_\_\_\_, allowed \_\_\_\_\_ to serve in that capacity without being properly licensed. The Complaint alleges that \_\_\_\_\_'s improper activity included supervising the areas of new accounts, correspondence, trading activity, compliance, advertising and continuing education.<sup>2</sup> \_\_\_\_\_ is also alleged to

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<sup>1</sup> Complaint, 4.

<sup>2</sup> Complaint, 5-6.

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have improperly supervised the firm's registered persons and served as the firm's Executive Representative.<sup>3</sup>

Based on these allegations, Enforcement charged the Respondents with violations of NASD's Membership and Registration Rules 1021(a) and 1022(a), and NASD Conduct Rule 2110.

B. Answer

The Respondents filed an Answer on August 20, 1999. The Respondents denied that \_\_\_\_\_ functioned as a General Securities Principal during the time period charged. The Respondents further stated that the firm is a municipal securities firm primarily dealing with institutional investors such as mutual funds, insurance companies and financial advisors. The Answer stated that \_\_\_\_\_ is properly registered as the firm's Municipal Securities Principal and performs the supervisory functions over the firm's municipal securities business. According to the Respondents, the firm will occasionally process a limited number of non-municipal securities transactions on an unsolicited basis, as an accommodation to its municipal securities clients and employees. These accommodation trades constitute a *de minimis* part of the firm's business.

C. The Hearing

The Hearing was held in Woodbridge, New Jersey on February 3, 2000, before a Hearing Panel composed of the Hearing Officer, and two current members of the District 9 Committee. Enforcement presented one witness, R. Robert Hessling, Jr. ("Hessling"), a Field

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<sup>3</sup> Complaint, 6.

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Supervisor in NASD Regulation, Inc.'s Kansas City office,<sup>4</sup> and also cross-examined \_\_\_\_\_ and \_\_\_\_\_, who each testified on his own behalf.

The Hearing Officer admitted into evidence 10 exhibits offered by Enforcement and 32 exhibits offered by the Respondents.<sup>5</sup> The Parties also offered a Joint Stipulation of Facts (“Stipulation”).

## **II. FINDINGS OF FACT AND CONCLUSIONS OF LAW**

### **A. Background of the Respondents**

\_\_\_\_\_ has been a member firm since 1990, with its place of business in New Jersey. The firm is a municipal securities firm primarily dealing with institutional investors such as mutual funds, insurance companies and financial advisors.<sup>6</sup> \_\_\_\_\_ processes a limited number of non-municipal securities transactions on an unsolicited basis as an accommodation to its municipal securities clients and employees.<sup>7</sup> Less than one percent of \_\_\_\_\_’ revenues was generated from non-municipal securities transactions in 1996, 1997 and 1998.<sup>8</sup>

In 1998, the firm employed eight registered persons, three of whom were General Securities Principals, and all of whom were General Securities Representatives.<sup>9</sup> In 1999,

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<sup>4</sup> Hearing Transcript, pp. 37-38.

<sup>5</sup> The exhibits for both Parties were offered without objection from the opposing Party. Joint Stipulation of Facts, 10-11.

<sup>6</sup> Stipulation, 7.

<sup>7</sup> Stipulation, 7; Answer, 6. The Membership Agreement allowed the firm to be a “Broker of the occasional trade in a U.S. Government or equity security, on an agency basis and executed by Pershing, as an accommodation for existing customers.” RX-19, p. 4.

<sup>8</sup> Stipulation, 7.

<sup>9</sup> Stipulation, 2.

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\_\_\_\_\_ employed 15 registered representatives, including four who were registered as General Securities Principals, and four who were General Securities Representatives.<sup>10</sup>

\_\_\_\_\_, age 34, is the firm's Municipal Securities Principal who performs supervisory functions over the firm's municipal securities business. He has been the firm's President and CEO since September 1996, when he purchased a 75 percent interest in the firm from his father, \_\_\_\_\_. In October 1998, \_\_\_\_\_ purchased the remaining ownership interest in the firm from his father, thereby becoming the 100 percent owner of \_\_\_\_\_. \_\_\_\_\_ became registered as a Municipal Securities Representative in 1993 and a Municipal Securities Principal in June 1996. In February 1998, \_\_\_\_\_ also became registered as a General Securities Representative.<sup>11</sup>

\_\_\_\_\_, age 61, is the founder and Chairman of \_\_\_\_\_. He has been registered with the NASD since 1962 and is currently registered as a General Securities Principal, Municipal Securities Principal, and a Financial and Operations Principal.<sup>12</sup> During the relevant time period, in addition to his obligations as Chairman of the firm, \_\_\_\_\_ had supervisory responsibility for customer complaints, books and records, bank records, supervision of off-site personnel, equities transactions, mutual funds transactions, and government securities transactions.<sup>13</sup>

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<sup>10</sup> Id.

<sup>11</sup> Stipulation, 3-4.

<sup>12</sup> Stipulation, 6.

<sup>13</sup> CX 1, pp. 2-3.

B. Supervision of the Non-Municipal Securities Business

In the fall of 1997, the NASDR staff conducted a routine examination of \_\_\_\_\_. As part of that examination, the NASDR staff raised concerns regarding the lack of proper supervision of the non-municipal securities business by a General Securities Principal. While the NASDR staff was conducting the on-site examination, the Respondents first learned that \_\_\_\_\_ was not registered as a General Securities Principal, as they had thought.<sup>14</sup> According to Hessling who supervised the on-site examination for the NASDR staff, \_\_\_\_\_'s registration had lapsed some time earlier "due to some administrative glitch, probably paperwork glitch."<sup>15</sup> As soon as that was discovered, the NASDR staff worked with \_\_\_\_\_ and the appropriate NASDR department to have \_\_\_\_\_ and another individual at the firm, \_\_\_\_\_, registered as General Securities Principals.

Since the Respondents were acting under a good faith belief that \_\_\_\_\_ was properly registered as a General Securities Principal,<sup>16</sup> and the lapse in his registration may well have been due to an administrative error by the NASD,<sup>17</sup> the Hearing Panel determined to treat \_\_\_\_\_'s actions as those of a properly registered General Securities Principal for the period in which there was the inadvertent lapse.

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<sup>14</sup> Hearing Transcript, p. 126.

<sup>15</sup> Hearing Transcript, p. 45. Although the record is not clear as to what caused \_\_\_\_\_'s registration as a General Securities Principal to lapse, Hessling acknowledged that it may have been an NASD error that caused the problem. Hearing Transcript, pp. 71-72.

<sup>16</sup> Hearing Transcript, p. 225.

<sup>17</sup> Hearing Transcript, pp. 71-72.

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From September 1996 through March 1999, \_\_\_\_\_ supervised the registered representatives as the Municipal Securities Principal by:

- ◆ Looking at and initialing order tickets for municipal and non-municipal transactions;
  - ◆ Reviewing and approving new accounts by signing the account opening forms;
  - ◆ Reviewing outgoing correspondence prepared by the firm's registered personnel;
  - ◆ Reviewing and initialing customer monthly account statements;
  - ◆ Signing Forms U-4 and U-5 for the firm's registered persons;
  - ◆ Supervising the firm's Continuing Education program, including its Firm Element training;
- and
- ◆ Serving as the firm's Executive Representative and primary contact with the NASD and other regulatory authorities.<sup>18</sup>

These supervisory activities were performed in accordance with \_\_\_\_\_'s responsibilities as a General Securities Principal under MSRB Rule G-27. As Enforcement has acknowledged, had the firm not engaged in any equity securities transactions, there would have been no challenge to \_\_\_\_\_'s performing these functions for the firm.<sup>19</sup> Enforcement argues that the Respondents violated NASD rules, however, by allowing \_\_\_\_\_ to perform these same functions as the supervisory principal for the non-municipal securities transactions, regardless of the limited number of transactions involved.

The Hearing Panel found that, given the nature of the firm's business, \_\_\_\_\_, as a Municipal Securities Principal, properly performed many of the functions that required

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<sup>18</sup> Stipulation, 9.

<sup>19</sup> Hearing Transcript, pp. 82-86.

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action by a principal. These included the approval of account opening forms,<sup>20</sup> the signing of Forms U-4 and U-5 for the firm's registered persons, supervising the firm's Continuing Education program, and serving as the firm's Executive Representative.<sup>21</sup> During the time period, there was no correspondence related to non-municipal securities transactions.<sup>22</sup>

Of those acts that required a General Securities Principal, most were performed by \_\_\_\_\_, who continued to be actively involved with the firm. Both Harvey and \_\_\_\_\_ testified that \_\_\_\_\_ initialed all tickets and reviewed daily trade blotters.<sup>23</sup> This is consistent with Hessling's testimony that \_\_\_\_\_'s signature appeared on order tickets.<sup>24</sup> The fact that \_\_\_\_\_ *also* reviewed and initialed tickets for non-municipal securities is of no consequence. It is neither unusual nor improper to have persons other than the General Securities Principal also review order tickets for regulatory, financial, or bookkeeping purposes.

The Respondents acknowledged, however, that only \_\_\_\_\_, and not his father, reviewed monthly account statements that included non-municipal trades.<sup>25</sup> This review was consistent with the firm's Supervisory Procedures and Compliance Manual, which listed

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<sup>20</sup> There is no evidence in the record that any accounts were opened for the purpose of effecting transactions in non-municipal securities.

<sup>21</sup> Hearing Transcript, p. 103.

<sup>22</sup> Hearing Transcript, pp. 146, 183.

<sup>23</sup> Hearing Transcript, pp. 143-144, 228.

<sup>24</sup> Hearing Transcript, p. 103. Enforcement did not offer into evidence any order tickets for non-municipal securities transactions that were initialed by only \_\_\_\_\_.

<sup>25</sup> Hearing Transcript, pp. 178, 200-204, 234.

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only \_\_\_\_\_ as the person responsible for reviewing and initialing firm copies of the monthly customer statements.<sup>26</sup> The Respondents considered such review by \_\_\_\_\_ to be unnecessary given the limited number of non-municipal transactions.<sup>27</sup> \_\_\_\_\_ stated that, as the firm's Compliance Officer and as a Municipal Securities Principal, he saw a regulatory purpose to having the monthly account statements reviewed for non-municipal transactions "if there were a lot more transactions,"<sup>28</sup> but not given the level of trading at the firm during the relevant period.

\_\_\_\_\_ testified that in 1998, there were 78 non-municipal securities transactions that were effected in approximately 20 customer accounts.<sup>29</sup> Of those, ten were accounts of employees.<sup>30</sup> In 1997, the firm effected 139 non-municipal securities transactions, also with a relatively small number of accounts.<sup>31</sup> According to \_\_\_\_\_, the firm did not review the monthly account statements reflecting these transactions any differently than other account statements.<sup>32</sup>

NASD Membership and Registration Rule 1021(a) states that "all persons engaged ... in the ... securities business of a member who are to function as principals shall be registered as such with the Association in the category of registration appropriate to the function to be

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<sup>26</sup> CX-1, p. 7.

<sup>27</sup> Hearing Transcript, pp. 178, 200-204, 234.

<sup>28</sup> Hearing Transcript, p. 201.

<sup>29</sup> Hearing Transcript, pp. 202-203.

<sup>30</sup> Hearing Transcript, pp. 202-203.

<sup>31</sup> Hearing Transcript, pp. 203-204.

<sup>32</sup> Hearing Transcript, p. 204.

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performed....” Rule 1022(a), notes that “each person associated with a member who is included within the definition of principal in Rule 1021, shall be required to register with the Association as a General Securities Principal ... unless his activities are so limited as to qualify him for one or more of the limited categories of principal registration specified hereafter.”<sup>33</sup> In this case, \_\_\_\_\_’s activities were not so limited as to qualify him for one of the specified limited principal registrations. Acting as a General Securities Principal while not properly registered constitutes conduct inconsistent with “high standards of commercial honor and just and equitable principles of trade,” in violation of NASD Rule 2110.

The SEC has held that “[a]ppropriate qualification and registration of securities firm personnel are important. Determining the level of activity permitted without registration involves analysis of all relevant facts and circumstances.”<sup>34</sup> In this case, although \_\_\_\_\_ was primarily involved in supervising the municipal securities segment of the firm’s business, he also exercised exclusive supervisory responsibilities for non-municipal securities transactions when he reviewed monthly customer account statements.

The responsibilities of the General Securities Principal cannot be delegated to someone who is not properly licensed to supervise that area of the firm’s securities business. The Respondents’ arbitrary determination that the number of transactions involved did not warrant the review of the General Securities Principal caused the firm to fall short of its regulatory

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<sup>33</sup> The limited principal registrations specified in the Rule were for a Financial and Operations Principal, Introducing Broker/Dealer Financial and Operations Principal, Investment Company and Variable Contracts Principal, Direct Participation Programs Principal, Registered Options Principal, and General Securities Sales Supervisor.

<sup>34</sup> Everest Securities, Inc., Exchange Act Release No. 37600 (August 26, 1996).

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obligation to properly review such trading. The review of monthly customer account statements, as required by the firm's own Supervisory Procedures and Compliance Manual, serves an important regulatory function that cannot be accomplished by merely reviewing order tickets.

The Hearing Panel finds that the Respondents improperly permitted \_\_\_\_\_ to act as a General Securities Principal by having him perform the supervisory responsibility of reviewing monthly account statements for those accounts that had non-municipal securities transactions. That was the responsibility of \_\_\_\_\_, the General Securities Principal. Instead of fulfilling his own obligations to review the customer account statements for the non-municipal transactions, \_\_\_\_\_ allowed those responsibilities to be carried out by \_\_\_\_\_, who he knew did not have the regulatory authority to act in that capacity. As Chairman and the firm's General Securities Principal with the designated responsibility for reviewing the non-municipal securities transactions, \_\_\_\_\_ should have acted to prevent this improper delegation of responsibilities.

Based on the foregoing, the Hearing Panel finds that the Respondents violated NASD Rules 1021(a), 1022(a) and 2110 as alleged in the Complaint.

### **III. SANCTIONS**

The NASD Sanction Guidelines ("Guidelines") recommend that, for violating the registration provisions, a fine ranging from \$2,500 to \$50,000 be imposed on a firm and responsible individuals.<sup>35</sup> In egregious cases, the Guidelines suggest suspending the firm with

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<sup>35</sup> NASD Sanction Guidelines, pp. 8-9 (1998 ed.) as amended by Notice to Members 99-98 (October 1999).

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respect to certain functions for up to 30 days, and suspending an individual for 30 days to two years, or barring the individual.<sup>36</sup>

Enforcement recommended that \_\_\_\_\_ and \_\_\_\_\_ be fined \$10,000, and that \_\_\_\_\_ be fined \$15,000 and suspended in a principal capacity for 60 days. In making that recommendation, Enforcement described what it saw as reckless behavior. It also suggested that the violation became more egregious when \_\_\_\_\_ continued to function in that capacity, and failed to sit for the General Securities Principal's examination, after having been informed by the NASDR staff of his need to qualify in that capacity.

The Respondents, while maintaining that no liability should be found, emphasized the limited nature of the non-municipal securities transactions and their eagerness to do what is necessary to rectify the problem. They described the extended time it took \_\_\_\_\_ to become qualified as a misunderstanding as to the urgency of the registration. The Respondents argued that the acts did not represent an egregious violation, and that no suspension would be warranted.

The Hearing Panel considered the arguments of the Parties and reviewed the principal considerations outlined in the Guidelines in determining the appropriate sanctions. In conducting that review, the Hearing Panel identified several mitigating factors. Specifically, the Hearing Panel found that the Respondents' actions were not intentional or reckless, but merely acts of negligence. The Respondents have taken affirmative steps to ensure future compliance by

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<sup>36</sup> NASD Sanction Guidelines, p. 43 (1998 ed.) as amended by Notice to Members 99-98 (October 1999).

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having \_\_\_\_\_ become registered as a General Securities Principal. There was no allegation or evidence that any customers were harmed or that the misconduct resulted in a monetary gain for the Respondents. The Hearing Panel rejected most of the allegations of inappropriate activity, finding that those acts were either effected by \_\_\_\_\_, as the firm's General Securities Principal, or by \_\_\_\_\_, as the firm's Municipal Securities Principal. Further, \_\_\_\_\_'s failure to promptly take the General Securities Principal's examination may have been caused at least in part by a breakdown in communications between the Respondents and the NASDR staff.<sup>37</sup>

Based on a review of its findings and the principal considerations, as described above, the Hearing Panel believes that this is not an egregious violation, and that mitigating factors call for sanctions significantly lower than those recommended by Enforcement. The Hearing Panel therefore fines the Respondents, \$3,000, jointly and severally.

#### **IV. CONCLUSION**

The Hearing Panel found that Respondents \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ violated NASD Rules 1021(a), 1022(a) and 2110 as alleged in the Complaint. The Hearing Panel fined the Respondents \$3,000, jointly and severally. These 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.

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<sup>37</sup> The responsibility for being properly licensed remained with the Respondents and did not shift to the NASDR staff. The Hearing Panel did consider such misunderstanding, however, when determining sanctions. Although the firm was located within the areas usually covered by the NASDR District 10 office, the on-site examination in 1997 was being conducted by the NASDR District 4 staff. Some lack of communication regarding follow-up from the examination may have caused some of the misunderstandings.

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The Hearing Panel also assessed joint and several costs against the Respondents in the amount of \$2,354, consisting of a \$750.00 administrative fee and \$1,604 for the cost of the Hearing transcript.<sup>38</sup>

Hearing Panel

by: \_\_\_\_\_  
Gary A. Carleton  
Hearing Officer

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<sup>38</sup> The Hearing Panel considered all of the arguments of the Parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.