

**NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS**

DEPARTMENT OF ENFORCEMENT,	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. CMS970028
v.	:	
	:	DECISION
	:	Hearing Panel
	:	
	:	June 3, 1998
Respondent.	:	

DIGEST

On September 4, 1997, the Department of Enforcement ("Enforcement" or "Complainant") served a Complaint on Respondent _____ ("Respondent" or "____") alleging six (6) causes of action:

Cause One: violations of NASD Conduct Rule 2110 and Interpretative Memorandum ("IM") 2110-2 for failing to execute contemporaneously a sale of 800 shares of a customer limit order after it sold that number of shares for its own market-making account;

Cause Two: violation of NASD Marketplace Rule 6220(a) for failing to report a transaction in an OTC Equity security to the Automated Confirmation Transaction Service ("ACT");

Cause Three: violation of NASD Marketplace Rule 4632(f) for failing to identify an aggregated transaction report in a Nasdaq National Market security in a manner as directed by the Association;

Cause Four: violations of NASD Conduct Rule 3110 and NASD Marketplace Rule 4632(f) for failing to identify two (2) order tickets of aggregated trades in a Nasdaq National Market security in a manner as directed by the Association;

Cause Five: violation of NASD Marketplace Rule 4632(a) for failing to report weekly to the Market Regulation Department, on Form T, last sale reports for fourteen (14) transactions in Nasdaq National Market securities that were not transmitted through ACT;

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and

Cause Six: violations of NASD Conduct Rules 2110 and 3010 for failing to establish, maintain, and enforce adequate written supervisory procedures reasonably designed to detect and deter violations of the Limit Order Protection Interpretation and the Rules of the Association relating to trade reporting.

The Hearing Panel found Respondent violated the NASD Conduct Rules and Marketplace Rules as alleged in the Complaint and, under the circumstances, determined the following sanctions were appropriate: with respect to Causes One, Five and Six, fines of \$1,000, \$2,000, and \$5,000, respectively, and with respect to Causes Two, Three, and Four, a letter of caution.

The Hearing Panel also assessed the costs of the Hearing against Respondent.

APPEARANCES

Michael J. King, Esq., Chief Litigation Counsel, and Peter D. Santori, Esq., NASD Regulation, Inc., Market Regulation Department, Rockville, Maryland. Rory C. Flynn, Esq., Chief Litigation Counsel, NASD Regulation, Inc., Department of Enforcement, Washington, DC, of counsel.

_____, Esq., _____, L.L.P., _____, _____, for Respondent

DECISION

I. Procedural Background

On September 4, 1997, Enforcement served a complaint on Respondent. The Complaint included six (6) causes of action alleging violations of the Limit Order Protection Interpretation and the Rules of the Association relating to trade reporting.

Cause One alleged that on or about May 1, 1996, Respondent failed to execute contemporaneously a customer limit order after it traded for its own market-making account at a price

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equal to or better than the customer limit order. This conduct was alleged to violate NASD Conduct Rule 2110 and IM-2110-2.

Cause Two alleged that on or about April 18, 1996, Respondent failed to report a transaction in an OTC Equity security to ACT in violation of NASD Marketplace Rule 6620(a).

Cause Three alleged that on or about April 18, 1996, Respondent failed to identify an aggregated transaction report in a Nasdaq National Market security in a manner directed by the Association in violation of NASD Marketplace Rule 4632(f).

Cause Four alleged that on or about April 18, 1996, Respondent failed to identify two order tickets of aggregated trades in a Nasdaq National Market security in a manner directed by the Association. This conduct was alleged to result in separate and distinct violations of NASD Conduct Rule 3110 and NASD Marketplace Rule 4632(f).

Cause Five alleged that on or about March 29 through April 22, 1996, Respondent failed to report weekly to the Market Regulation Department, on Form T, last sale reports for fourteen (14) transactions in Nasdaq National Market securities that were not transmitted through ACT. Each transaction was alleged to result in a separate and distinct violation of NASD Marketplace Rule 4632(a).

Cause Six alleged that Respondent failed to establish, maintain, and enforce adequate written supervisory procedures reasonably designed to detect and deter the violations described in the Complaint, in violation of NASD Conduct Rules 2110 and 3010.

Respondent filed an Answer on October 2, 1997. Respondent admitted, with explanation, the allegations of Causes One, Two, Three and Five and denied the allegations of Causes Four and Six.

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On November 17, 1997, Enforcement filed a Motion for Summary Disposition (the "Motion") as to the allegations set forth in all six (6) causes of action. Enforcement argued that with respect to Causes One, Two, Three, and Five, summary disposition was appropriate since the allegations were admitted by Respondent.¹ As to Cause Four, Enforcement argued that it was undisputed that Respondent did not identify the order tickets as bunched or aggregated in a manner as directed by the Association and, accordingly, it was entitled to judgment as a matter of law.² As to Cause Six, Enforcement argued that it was entitled to judgment as a matter of law because Respondent's written supervisory procedures did not identify any steps or mechanisms to be followed by any person to ensure that Respondent was complying with the Association's trade reporting rules and Limit Order Protection Interpretation.³

Respondent filed a Response and Opposition to Enforcement's Motion on November 28, 1997. Respondent did not oppose the Motion with respect to Causes One, Two, Three, and Five, but reserved the right to present to the Hearing Panel evidence of mitigating circumstances in connection with any sanctions regarding these Causes.⁴ Respondent opposed the Motion with respect to Causes Four and Six. With respect to Cause Four, Respondent argued there was a genuine issue of material

¹ Complainant's Statement of Undisputed Facts and Memorandum of Points and Authorities in Support of Motion for Summary Disposition ("Complainant's Mem.") at 3.

² Complainant's Mem. at 3-4. This failure was alleged to result in separate and distinct violations of NASD Marketplace Rule 4632(f) and NASD Conduct Rule 3110. *Id.* at 3. NASD Marketplace Rule 4632(f)(2) provides "[t]he reporting member shall identify aggregated transaction reports and order tickets of aggregated trades in a manner directed by the Association." NASD Conduct Rule 3110(a) requires Association members to maintain books, records, and other documents in conformity with the rules, regulations, and policies of the Association.

³ Complainant's Mem. at 5. This failure was alleged to violate NASD Conduct Rules 2100 and 3010. NASD Conduct Rule 3010(b)(1) provides "[e]ach member firm shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of this Association."

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fact as to the issue in dispute: i.e. whether, in fact, the Association had directed the manner in which order tickets were to be marked to identify bunched or aggregated trades.⁵ As to Cause Six, Respondent argued that there was a genuine issue of material fact whether its written supervisory procedures were reasonably designed to achieve compliance with the Association's rules as required by NASD Conduct Rule 3010(b).⁶ Further, Respondent argued that, as a matter of law, Enforcement's position as to the level of specificity required for written supervisory guidelines was not supportable.⁷

After reviewing the filings of the Parties, the Hearing Panel deferred decision on the Motion pending the disciplinary hearing.⁸

The Parties presented evidence to a Hearing Panel in a one day hearing held in Minneapolis, Minnesota on December 17, 1997.⁹ Enforcement presented one witness at the hearing, _____ ("____"), a team leader employed in the Market Regulation Department of NASD Regulation, Inc.¹⁰ Respondent presented two witnesses -- _____ ("_____"), a former Senior Vice President

⁴ Respondent's Response and Opposition to Complainant's Motion for Summary Disposition at 1.

⁵ Respondent's Memorandum of Authorities in Opposition to Motion for Summary Disposition ("Respondent's Opp.") at 3-4. Respondent also argued that the use of its "ALEX" designation provided _____ with a sufficient method for identifying aggregated or bunched trades.

⁶ Respondent's Opp. at 4-5.

⁷ Respondent's Opp. at 7-8.

⁸ The Parties were informed of the Hearing Panel's decision during the Final Pre-Hearing Conference on December 9, 1997. The decision of the Hearing Panel on the Motion also is reflected in the Hearing Officer's Final Pre-Hearing Order of that date.

⁹ References to the testimony set forth in the hearing transcript will be designated as "Tr." References to Enforcement's Exhibits admitted at the hearing will be designated as "CX-." References to Respondent's Exhibits admitted at the hearing will be designated as "RX-."

¹⁰ _____ works for the section known as the Trading and Market Making Surveillance section or "TAMS." Tr. at 35-36. The TAMS program examines the trading and market-making activity of "tier one" firms. Tr. at 36.

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and Director of Equity Trading at _____,¹¹ and _____ ("_____"), a capital markets compliance examiner for Respondent.¹²

At the request of the Hearing Panel, the Parties submitted post-hearing briefs on February 24, 1998.¹³ The Hearing Panel specifically asked the Parties to address the two remaining disputed causes -- Cause 4 and Cause 6 -- and also, as to each separate violation alleged in the Complaint, to discuss any aggravating or mitigating factors the Hearing Panel should consider with respect to sanctions.

II. Background of the Proceeding and Position of the Parties

The alleged violations which form the basis for this disciplinary proceeding arise as a result of an examination conducted by the staff of the Market Regulation Department of NASD Regulation, Inc.¹⁴ The purpose of the examination was to determine Respondent's compliance with the applicable rules and regulations relating to trading and market making activity.¹⁵

¹¹ _____ held these positions from October 1995 through April 1996, the relevant period for purposes of this disciplinary proceeding. Tr. at 135-36.

¹² Tr. at 259.

¹³ The Hearing Officer's February 11, 1998, Report and Order Regarding Post-Hearing Status Conference extended the time for the Parties to file post-hearing briefs from February 17 to February 24, 1998. At the Post-Hearing Status Conference the Parties were informed that one Panelist had withdrawn because of a conflict of interest which developed subsequent to the hearing. The Parties also were informed that the remaining Panel would render a decision and both Parties affirmatively represented that they had no objection. References to Enforcement's post-hearing brief will be designated as "Enforcement's Br." References to Respondent's post-hearing brief will be designated as "Respondent's Br."

¹⁴ _____ conducted the examination of _____ which resulted in the issuance of the Complaint. (Tr. at 37). _____ reviewed 125 consecutive trade reports for April 18, 1996 and all trades around those trade reports. He also reviewed 25 customer confirmations for the same period, Form T's that were submitted in April 1996, 77 limit orders for the period of April 30-May 10, 1996, Respondent's written supervisory procedures, and any other reports or memoranda pertaining to trade market making activities for the period from October 1995 through April 1996. Tr. at 37-38.

¹⁵ Tr. at 36-41.

The facts as to the allegations of Causes One, Two, Three, and Five are undisputed and the allegations are admitted as to those Causes by Respondent.¹⁶ Many of the facts as to Causes Four and Six also are undisputed, but the Parties differ as to the whether Respondent's conduct violates the Association's rules at issue.

A. Cause Four

Enforcement alleges that on or about April 16, 1996, Respondent failed to identify two (2) order tickets of aggregated trades in a Nasdaq National Market security "in a manner directed" by the Association as required by NASD Marketplace Rule 4632(f). Enforcement contends that that the Association "directed" its members to mark order tickets of aggregated trades with a ".B" modifier.¹⁷

Respondent admits that the order tickets at issue were not marked with a ".B" modifier,¹⁸ but contends that the Association never has provided any clear direction to members as to the manner in which order tickets for aggregated transactions should be identified. Respondent also argues that use of its internal designation "ALEX" complied with the requirement of Marketplace Rule 4632(f) by providing an acceptable method for identifying bunched or aggregated order tickets.¹⁹

¹⁶ See Respondent's Answer and Respondent's Response and Opposition to Complainant's Motion for Summary Disposition. Because the allegations as to Causes One, Two, Three, and Five are admitted, Enforcement is entitled to judgment on these Causes. Accordingly, with respect to these Causes, this Decision only will address the issue of sanctions.

¹⁷ Enforcement Br. at 4, 10-13; Tr. at 96.

¹⁸ Tr. at 30.

¹⁹ Respondent's Br. at 2-5.

B. Cause Six

Enforcement alleges that Respondent failed to establish, maintain, and enforce adequate written supervisory procedures reasonably designed to detect and deter the violations described in the Complaint in violation of NASD Conduct Rules 2110 and 3010. Enforcement's position is that Respondent's written supervisory procedures did not contain sufficient steps or establish any mechanisms to be followed by any specific person to ensure that Respondent's associated and registered persons were complying with the Association's trade reporting and limit order rules.²⁰

Respondent's position is that the level of specificity advocated by Enforcement for written supervisory procedures is not found in NASD Conduct Rule 3010(b) or any NASD Notice to Members, nor is such specificity supported by the applicable case law.²¹ Respondent's position also is that its written supervisory guidelines are reasonably designed to achieve compliance with the Association's rules as required by NASD Conduct Rule 3010(b).²²

III. Findings of Fact and Conclusions of Law

A. Cause Four

1. Evidence Presented at the Hearing

Enforcement presented evidence that at 11:08:00 a.m. on April 18, 1996, Respondent executed two customer sell orders in _____. ("_____"), a Nasdaq National Market Security, at 25 ½, one for 500 shares and the second for 100 shares.²³ Respondent reported these trades as one 600

²⁰ Enforcement's Br. at 3, 4-10, and 13-18.

²¹ Respondent's Br. at 7-8

²² Respondent's Br. at 8-10.

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share transaction at 11:08:30, but did not include a ".B" modifier on the order tickets.²⁴ _____ testified that because this was a "bunched transaction," the order tickets should have been marked with a ".B" modifier.²⁵

On cross-examination, _____ testified that he was aware of two Association documents which directed members to mark order tickets as bunched for trade reporting with a ".B" modifier.²⁶

_____ testified that these documents were provided to members who had a work station.²⁷

Respondent does not dispute the fact that the order tickets were not marked with a ".B" modifier to designate a bunched or aggregated trade. Rather, _____, testified that the two documents relied upon by Enforcement, the Symbol Directory and the Quick Reference Guide, were used only by traders at the trading desks and were not distributed to the sales representatives.²⁸

_____ testified as to the history of NASD Rule 4632(f) and that the "order tickets" referenced in the Rule no longer exist with an electronic order entry system.²⁹ _____ also testified that an

²³ The two order tickets, CX-8 and CX-9, reflecting two individual executions in _____, were reported by Respondent to ACT as one transaction. Tr. at 58-60. See also CX-10 and CX-11.

²⁴ Tr. at 58-60. It is undisputed that Respondent did not include a ".B" modifier on the order tickets. See Answer of Respondent at ¶ 14, Tr. at 29-31, 233, and Respondent's Br. at 4. Rather, the issue is whether the Association directed its members to use the ".B" modifier exclusively on order tickets to designate bunched trades. See Enforcement's Br. at 3-4 and Respondent's Br. at 2-5. Respondent contends that its use of the "ALEX" designation provides Respondent and its auditors with sufficient information for identifying bunched trades. Tr. at 30, 167; Respondent's Br. at 4.

²⁵ See Tr. at 65-66.

²⁶ Tr. at 91-97; CX-12 and CX-13. CX-12 is "The Nasdaq Stock Market Symbol Directory" ("Symbol Directory"), and CX-13 is the "Nasdaq, OTC, and CQS Trade Reporting Quick Reference Guide" ("Quick Reference Guide"). The Parties entered into a stipulation as to the distribution of these documents to NASD member firms. See Stipulation filed with the Office of Hearing Officers on December 15, 1997. The Stipulation was accepted by the Hearing Panel. Tr. at 86.

²⁷ Tr. at 92.

²⁸ Tr. at 171-172.

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internal designation of "ALEX" on the subject order tickets provided sufficient information to Respondent that they were part of a bunched trade.³⁰

2. Findings

NASD Marketplace Rule 4632(f) provides in pertinent part: [t]he reporting member shall identify * * * order tickets of aggregated trades [in Nasdaq National Market Securities] in a manner directed by the Association." The Hearing Panel finds that through the distribution of the Symbol Directory³¹ and the Quick Reference Guide,³² the Association directed member firms to mark order tickets for aggregated trades with a ".B" modifier.³³ Both documents provide, in pertinent part as follows:

²⁹ Tr. at 172-174.

³⁰ Tr. at 167. On cross-examination, however, _____ admitted that the ALEX designation was not used exclusively to indicate that the trades were part of a bunched transaction. Tr. at 233-34. Rather, _____ testified that the ALEX designation served several functions and that it could refer to something other than a bunched trade. Id.

³¹ CX-12.

³² CX-13.

³³ In 1984, NASD issued Notice to Members 84-46 which announced that the Securities and Exchange Commission had approved amendments to Section 2(f) of Part XIV of Schedule D of the Association's by-laws. This section was the predecessor to NASD Marketplace Rule 4632(f), concerning the ability of NASD members to aggregate or "bunch" trades in Nasdaq National Market System Securities into a single transaction report. The Notice to Members also reminded members that other aspects of the bunching rule remained unchanged, including the requirement that "[t]he reporting member * * * identify each bunched trade report by appending a ".B" to the trade report; and [a]ll order tickets of bunched trades must be identifiable by the member." Notice to Members 84-46 did not direct the manner in which order tickets of aggregated trades should be identified. The Hearing Panel finds that such direction was given by the Association to its members in the Symbol Directory and Quick Reference Guide. Although there may have been an earlier edition, the Symbol Directory, CX-12, reflects that an edition was published in December 1995. Similarly, although there may have been an earlier addition, the Quick Reference Guide, CX-13, reflects that it was issued in December 1994. Moreover, the Parties agreed that in December 1995, the Association distributed at least one copy of the Symbol Directory to all members that possessed a Nasdaq work station and that since December 1995, and at all times relevant to the Complaint, Respondent possessed at least one Nasdaq work station. Stipulation of December 12, 1997, at ¶1. Similarly, the Parties agreed that Respondent received at least one copy of the Quick Reference Guide some time prior to March 1996, which predates all the violations alleged in the Complaint. Id. at ¶2.

.B Bunched Trade-Use for aggregated/bunched transaction reported within 90 seconds. Bunching is permitted for Nasdaq National Market and The Nasdaq SmallCap Market issues if all of these conditions are met:

- The tickets must indicate transaction was bunched for trade reporting.

The Hearing Panel finds that the order tickets at issue do not indicate that the transaction was bunched for trade reporting in the manner directed by the Association in the Symbol Directory and Quick Reference Guide. The Hearing Panel also finds that at all times relevant to the Complaint, Respondent had a least one copy of the Symbol Directory and the Quick Reference Guide which directed the manner in which order tickets for aggregated/bunched trades should be marked for trade reporting.³⁴ Thus, the Hearing Panel finds that Respondent's failure to mark the order tickets with a ".B" modifier, as directed by the Association, was a violation of NASD Rule 4632(f).

The Hearing Panel, however, also agrees with Respondent that NASD Rule 4632(f) has failed to keep pace with technology since the "order tickets" contemplated by the Rule no longer exist in an electronic trading environment. The Rule was written in 1984 and the language at issue virtually has remained unchanged to this day. The Rule does not reflect the electronic trading processes used today or the fact that "order tickets" are completed by the sales representative and not by the trader.³⁵ With the advent of electronic trading systems, member firms developed policies and procedures which permit traders to report trades to tape as quickly as possible, allowing the details of the trade --such as an aggregated trade -- to be assigned later.³⁶ Thus, although the Hearing Panel finds that Respondent's

³⁴ Stipulation of December 12, 1997.

³⁵ It should be noted, however, that Respondent's written supervisory guidelines did not contain any instructions to traders to ask sales representatives whether the trade was part of a bunched transaction. Cf. RX-19 at 20, Respondent's "Equity Trader's Manual Updated 10/97" (instructing traders to ask whether a trade represents a bunched order when accepting telephone orders).

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failure to mark the "order tickets" with a ".B" modifier is a violation of Rule 4632(f)(2),³⁷ the Hearing Panel also finds that the Rule is not necessarily reflective of current industry practice.

B. Cause Six

1. Evidence Presented at the Hearing

_____ testified that as part of the examination process, Respondent was asked to produce "all written supervisory procedures, internal reports or other memorandum [sic] pertaining to trading activities and market-making activities for the period of October 1995 to April 1996."³⁸ In response to this request, Respondent provided a 33-page document captioned "Trading Department Employee Policies and Procedures, August 1995" (hereafter referred to as "Respondent's written supervisory guidelines").³⁹

Based on his review of the documents provided by ____, _____ concluded that written procedures to achieve compliance with the Association's trade reporting and the customer limit order protection "do not exist."⁴⁰ Specifically, _____ testified that Respondent's written supervisory guidelines are deficient in the following respects: (1) failure to set forth mechanisms to ensure compliance with the rules and regulations relating to trade reporting and the Limit Order Protection Interpretation;

³⁶ To comply with the language of NASD Marketplace Rule 4632(f)(2), member firms would need to rely on sales representatives to mark "order tickets" with a ".B modifier" for aggregated trades since the trader does not have the order tickets.

³⁷ Since Respondent violated NASD Marketplace Rule 4632(f), the Hearing Panel also finds that Respondent violated NASD Conduct Rule 3110(a).

³⁸ Tr. at 132-33.

³⁹ CX-15; Tr. at 68-69, 132-33. This document consists primarily of guidelines for traders, copies of internal memoranda, and reprints of NASD publications or announcements. The last two (2) pages of this document, captioned "Department Manager's Supervisory Guidelines" (CX-15 at 32-33), are general instructions with respect to "inventories" and "employee trading."

⁴⁰ Tr. at 70-74.

(2) failure to set forth specific controls for supervisors designed to deter and detect misconduct involving the rules and regulations relating to trade reporting and the Limit Order Protection Interpretation; (3) failure to identify the person or persons responsible for ensuring compliance with the rules relating to trade reporting and the Limit Order Protection Interpretation; (4) failure to set forth the steps that supervisory personnel would take to ensure compliance with the trade reporting rules and the Limit Order Protection Interpretation; (5) failure to identify how often steps would be taken to ensure compliance with the rules and regulations relating to trade reporting and the Limit Order Protection Interpretation; (6) failure to set forth how reviews or steps to ensure compliance with respect to timely, accurate trade reporting and the Limit Order Protection Interpretation would be evidenced.⁴¹ _____ testified that in order to "satisfy the rule," these specific items and methods of review must be present.⁴²

On cross-examination, _____ testified that with respect to trade reporting specifically, in order to comply with NASD Rule 3010(b), Respondent's written supervisory guidelines needed to designate the individual responsible for trade reporting review, including when the person's title was obtained, the person's registration status, and the location of the individual. In addition, _____ testified that the written supervisory guidelines should detail "what they're looking for, how they review for it, what documents they used to review for it, how frequently they reviewed those documents, and how they would evidence such a review."⁴³

⁴¹ Id.

⁴² Tr. at 106-07.

⁴³ Id.

At the hearing, upon examination by Enforcement, _____ identified those portions of Respondent's written supervisory guidelines designed to achieve compliance with the trade reporting rules and the Limit Order Protection Interpretation during the period October 1995 through April 1996.⁴⁴ In addition, on direct examination, _____ testified as to other procedures and controls used by Respondent to achieve compliance. Such procedures included review of computer generated reports which provided information designed to assist Respondent to achieve compliance with the Association's rules governing trading;⁴⁵ efforts by _____ to monitor Respondent's supervisory system, keep it current, and have its computerized trading systems generate the reports necessary to achieve compliance;⁴⁶ and reviews of trade reporting information and periodic audits by the Compliance Department.⁴⁷

2. Findings

NASD Conduct Rule 3010 provides in pertinent part:

(a) Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and the Rules of this Association. * * * A member's supervisory system shall provide, at a minimum, for the following:

(1) The establishment and maintenance of written procedures as required by paragraph (b) and (c) of this Rule.

* * *

⁴⁴ Tr. at 177-181, 221. See also Enforcement's Br. at 5-8 and Respondent's Br. at 9.

⁴⁵ Tr. at 139-47, 150-53, 155, 164-65. See also CX-3, CX-10, CX-15, RX-6, and RX-7.

⁴⁶ Tr. at 157-58. See also RX-12 and RX-13. _____ testified at length with respect to Respondent's problems during its conversion to the Brass system for trade reporting from its in-house Beta system. Tr. at 146-47, 157-66, 169-171.

⁴⁷ Tr. at 145-46, 153-54, 260-61. See also RX-6, RX-9, and RX-10.

(b)(1) Each member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of this Association.

(b)(2) The member's written supervisory procedures shall set forth the supervisory system established by the member pursuant to (a) above, and shall include the titles, registration status, and location of required supervisory personnel and the responsibilities of each supervisory personnel as these relate to the types of business engaged in, applicable securities laws and regulations, and the Rules of this Association.

* * *

The Parties disagree as to how much specificity is required in written supervisory procedures to comply with NASD Conduct Rule 3010. Enforcement contends that "written supervisory procedures that do not contain the level of specificity advocated by Complainant in this proceeding are neither reasonable nor enforceable within the meaning of NASD Conduct Rule 3010."⁴⁸ In addition to the testimony of ___ ___, Enforcement relies primarily on the decision of the Securities and Exchange Commission ("SEC") in In re Gary E. Bryant ("Bryant") to support its position.⁴⁹

Respondent, on the other hand, contends that the criteria _____ testified as being required by NASD Conduct Rule 3010 are not mentioned anywhere in the Rule, nor in any Notice to Members describing or discussing the Rule's relevant language "from its introduction in 1988 through the date of the hearing * * *."⁵⁰ Respondent, relying on recent case law, argues that the level of specificity

⁴⁸ Enforcement's Br. at 15-16. See discussion at pp. 12-14, infra.

⁴⁹ Exchange Act Release No. 32357, 54 S.E.C. Docket 345, 1994 SEC LEXIS 1347 (May 24, 1993). See Complainant's Br. at 14-15.

⁵⁰ Respondent's Br. at 6-7.

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"demanded by _____"⁵¹ is not supportable and that the applicable standard is "'procedures reasonably designed to achieve compliance' with the Association's rules."⁵² Respondent also contends that the Association "recognized that the degree of detail in supervisory procedures will necessarily vary depending on the business activity of the member" * * * and "that the supervisory procedures for retail (sales) activity are likely to be more extensive than for others."⁵³

The Hearing Panel finds that, at a minimum, NASD Conduct Rule 3010 requires a member to have written supervisory procedures that set forth the responsibilities of each supervisory person as they relate to the types of business engaged in, the applicable securities laws and regulations, and the Rules of the Association. In addition, the member's written supervisory procedures must be reasonably designed to achieve compliance with applicable securities laws and regulations, and the applicable Rules of this Association. In applying and interpreting the "reasonableness" standard of the Rule, the Association recognizes that no set of written procedures, no matter how comprehensive, can address

⁵¹ Respondent's Br. at 7-9.

⁵² Id. at 8. Applying this standard, Respondent contends that Enforcement failed to prove, by a preponderance of the evidence, that Respondent's written supervisory procedures were not reasonable to achieve compliance with the Association's trade reporting and customer limit order protection rules.

⁵³ Respondent's Br. at 6-7. Respondent relies on RX-24, Notice to Members ("NTM") 89-34, "Guidelines for Compliance with Article III, Section 27 of the NASD Rules of Fair Practice Re: Supervisory Practices and Procedures" (April 1989), specifically the answer to the first question therein to support this proposition. Tr. at 110-11. This document includes a series of questions and answers regarding supervisory practices and procedures and was issued in connection with amendments to the Association's supervision rule. The first question addresses whether a supervisory system must cover all operations of the firm or only retail sales. The answer states that the supervisory system must cover all aspects of the firm's banking and investment business and gives some examples. As an example of the requisite level of detail, the answer stated that supervisory procedures for retail sales "are likely to be more extensive than for other areas" because of "detailed regulatory requirements". RX-24 at 1. The regulatory requirements concerning the timely, accurate, and complete reporting of transactions to the Association (many of which were enacted subsequent to NTM 89-34) are equally detailed (see, e.g., Marketplace Rules 4630-4632, 4640-4643, 4650-4652, 6100-6190, 6400-6450, 6500-6550, 6600-6620, and 6700-6750) and, thus, also should be addressed in some detail in a member's written supervisory procedures. Similarly, the regulatory requirements for the Limit Order Protection Interpretation, NASD Conduct Rule IM-2110-2 (enacted five years subsequent to NTM 89-34), is analogous to the detailed regulatory requirements applicable to retail activity since it is premised on the principle of

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compliance with "each federal, state, and self-regulatory rule and regulation." Market Surveillance Committee v. Patten, ("Patten"), Complaint No. CMS960085 at 6 (NAC Feb. 3, 1998). Rather, "each firm's written procedures must be reasonably designed to supervise the business activities in which it is engaged." Id.⁵⁴

The SEC provides further guidance as to what is required for written supervisory guidelines to comply with NASD Conduct Rule 3010(b). For example, it states that "to ensure investor protection, a broker-dealer must establish and enforce effective procedures to supervise employees." Bryant, 1994 SEC LEXIS 1347 at *19.⁵⁵ In Bryant, the SEC found Respondent's written supervisory guidelines deficient since there were no mechanisms for ensuring compliance and they did not establish specific functions to be followed by the person identified as responsible for ensuring compliance by the firm and its registered representatives. Id. at 20. Similarly, in In re Black, Exchange Act Release No. 33187, 55 S.E.C. Docket 1216, 1993 SEC LEXIS 3131 at *7 (November 12, 1993), the SEC found that the firm's written supervisory procedures were not adequate because there was no written description of

investor protection. Thus, this Rule also should be addressed in some detail in a member's written supervisory procedures.

⁵⁴ In Patten, the NAC found that since Respondent GMIS, the member firm, had a work station which enabled Respondent Patten to enter trades, it was necessary for Respondent GMIS "to have written supervisory procedures reasonably [designed] to ensure compliance in the area of trade reporting." Id.

⁵⁵ In Bryant, the Respondent firm's written supervisory procedures consisted of "two pages of specific procedures with a one-page addendum enumerating 18 'prohibited business practices'." Market Surveillance Committee v. Anderson, Bryant & Co., Complainant No. MS-803 at 18 (August 1, 1991). In sustaining the Association's decision, the SEC found that the Respondent firm's written supervisory procedures provided "nothing more than a list of things that the firm and its representatives should not do." 1994 SEC LEXIS 1347 at 20. The SEC also found that "the firm's structure included no specific controls or supervisory procedures designed to deter or detect misconduct." Id. See also Market Regulation Committee v. Castle Securities Corp., Complaint No. CMS 940100, 1996 NASD Discip. LEXIS 37, at *24-6 (NBCC October 21, 1996), aff'd, In re Castle Securities Corp., Exchange Act Release No. 39523, 66 S.E.C. Docket 531, 1998, SEC LEXIS 24 (Jan. 7, 1998); In re Freeland, Exchange Act Release No. 32192, 53 S.E.C. Docket 2452, 1993 SEC LEXIS 878 at *6 (April 22, 1993).

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the supervisory chain of command and no current written procedures designed to detect excessive or unsuitable trading in a customer's account.⁵⁶

A member's written supervisory procedures may not require the degree of specificity advocated by Enforcement at the Hearing in order to comply with NASD Conduct Rule 3010. The Hearing Panel finds, however, that those portions of Respondent's written supervisory procedures that _____ identified as designed to achieve compliance with trade reporting rules and the Limit Order Protection Interpretation are deficient in a number of respects.

First, they do not identify the title, registration status, and location of any supervisor or manager responsible for ensuring compliance with the trade reporting and limit order rules. Respondent's written supervisory procedures include only a management organizational chart which does not provide any of the above information or allocate any responsibility for ensuring compliance with any of the Association's rules or regulations.⁵⁷

⁵⁶ See also In re Scott, Exchange Act Release No. 33485, 55 S.E.C. Docket No. 2409, 1994 SEC LEXIS 155 at *23-27 (January 14, 1994). The SEC found the member's written supervisory procedures "provided no meaningful guidance on the manner in which compliance could be achieved with NASD's markup policy. * * * Nor did the firm establish mechanisms for ensuring compliance with the NASD's free riding and withholding interpretation. The procedures manual provided nothing more than a description of persons who were prohibited from purchasing new 'hot issues.' It included no procedures for ensuring that such persons were identified when they opened new accounts, or for verifying that a purchase of a 'hot issue' was not by a prohibited person." Id. at * 24.

⁵⁷ CX-15 at 3. _____ testified that the chart on p. 3 of CX-15, in conjunction with pages 32-33 of this Exhibit, set forth his responsibilities and his manager's responsibilities "in conducting their various lines of business." Tr. at 137-38. See also Tr. at 182 and Respondent's Br. at 9, n. 17. This last portion of Respondent's written supervisory guidelines (pp. 32-33), however, which is captioned "Department Manager's Supervisory Guidelines," only addresses, in broad terms, "inventories" and "employee trading" and provides no detail at all concerning how to monitor for compliance with the Association's trade reporting rules or the Limit Order Protection Interpretation. Cf. RX-18 at 8-20 (identifying the responsible party and the action required for review of compliance with the Limit Order Protection Interpretation and the Association's trade reporting rules). RX-18 is a draft of Respondent's written supervisory procedures dated September 1997. See Tr. at 268-69. In fact, on cross-examination, _____ admitted that the "organizational" chart on page 3 of CX-15 did not identify the person(s) responsible for monitoring compliance. Tr. at 182-185.

Second, Respondent's written supervisory procedures do not identify any procedures to be followed by any specified individual (e.g., trading manager, compliance officer, or other person) to ensure that Respondent's registered persons are complying with the Association's trade reporting rules and Limit Order Protection Interpretation. The only reviews managers are directed to conduct are listed under the sections Records Surveillance,⁵⁸ Periodic Reviews,⁵⁹ and Inventories and Employee Trading.⁶⁰ None of these sections directs any person to do a review for compliance with the trade reporting rules or the Limit Order Protection Interpretation.⁶¹ Similarly, the Hearing Panel finds that the review of tickets, inventories, and employee trading, described in the last three sections of Respondent's written supervisory guidelines, could not have been used to monitor for compliance with the trade reporting rules or the Limit Order Protection Interpretation because of the narrow scope of the reviews⁶² and the limited documents to be used during such reviews.⁶³

⁵⁸ CX-15 at 8, specifically the following daily reports: profit and loss, closing position, daily activity. See also Tr. at 141-42.

⁵⁹ CX-15 at 31, specifically directing the "block trading manager" to review, on a rotating basis, all block trading tickets at least one day a week and directing the manager of agency trading to review, at least one day a week, all tickets received from and executed by Respondent's agency traders.

⁶⁰ CX-15 at 32-33.

⁶¹ By way of example, _____ admitted that none of the reports listed under "Records Surveillance" (CX-15 at 8), i.e., the profit and loss report, the closing position report, or the daily activity report, was used by a manager or assistant manager to verify the accuracy of the traders' trade reports or to monitor compliance with the trade reporting rules or the Limit Order Protection Interpretation. Tr. at 199-206, 215, 217. Respondent introduced no evidence at the hearing, documentary or otherwise, that the reports identified under "Records Surveillance" of Respondent's written supervisory guidelines were used for any compliance reviews.

⁶² _____ admitted that the instructions with respect to review of block trading tickets (CX-15 at 31) do not instruct the block trading manager to review the tickets to ensure that block trades are reported within 90 seconds of execution or for compliance with the trade reporting rules or limit order protection interpretation. Tr. at 222-23, 225. _____ also admitted that there were no instructions or directions with respect to the paragraph pertaining to

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The Hearing Panel finds that an apparent principal purpose of Respondent's written supervisory guidelines was to inform Respondent's "Trading Department Employee[s]"⁶⁴ of "Guidelines,"⁶⁵ "Activities,"⁶⁶ and "Conduct."⁶⁷ Respondent's written supervisory guidelines, however, contain no instructions to managers, supervisory personnel, or other persons charged with compliance to ensure that Respondent's trading department employees are complying with the Association's trade reporting rules or the Limit Order Protection Interpretation.⁶⁸ Thus, although Respondent's written supervisory guidelines provide some guidance to trading department employees in the conduct of their business, they place the primary responsibility to ensure compliance with the Association's rules and regulations on the registered representatives and associated persons and not on Respondent itself.⁶⁹ In other words, the Hearing Panel finds there is a "gap" between the instructions to Respondent's traders and how supervisory personnel should and would monitor for compliance.

SOES protection or under the section entitled "Department Manager's Supervisory Guidelines" (CX-15 at 31-33) to conduct a review for compliance with the trade reporting rules or the limit order protection. Tr. at 225-26.

⁶³ Moreover, the Respondent's written supervisory guidelines do not tell any manager, assistant manager, compliance person, or anyone in a supervisory position, how to conduct a review for purposes of monitoring for compliance with the Association's trade reporting rules or the Limit Order Protection Interpretation or how often such reviews should be conducted. Although the exact level of specificity advocated by Enforcement at the hearing (see Tr. at 106) may not be necessary for a member's written supervisory guidelines to comply with NASD Conduct Rule 3010, Respondent's written supervisory guidelines contain no instructions or recommendations at all in this respect.

⁶⁴ CX-15 at 1.

⁶⁵ CX-15 at 4-6, 11-12, and 16-17.

⁶⁶ CX-15 at 7 and 8.

⁶⁷ CX-15 at 7.

⁶⁸ After identifying certain pages of CX-15 as containing Respondent's written supervisory procedures to achieve compliance with the trade reporting rules, Tr. at 177-181, _____ admitted that they did not set forth any steps or procedures to ensure that traders were doing what they were told to do. See, e.g., Tr. at 190-91, 195-199.

In at least one proceeding where Respondent was charged with a violation of Rule 3010, the Association looked outside the four corners of a member's written supervisory guidelines to determine whether other procedures in conjunction with the written supervisory guidelines were reasonably designed to ensure compliance within the meaning of NASD Conduct Rule 3010. District Business Conduct Committee No. 5. v. A.S. Goldman & Co., Complaint No. C05930094, 1995 NASD Discip. LEXIS 14, at * 22 (NBCC March 6, 1995). In Goldman, the Association concluded that there were other written compliance guidelines which had been instituted by Respondent's new accounts department and which could not be ignored "merely because they are not referenced in the [supervisory] manual." Id.

In this case, however, the Hearing Panel finds that the evidence introduced at the hearing does not support a finding that Respondent actually conducted supervisory reviews or implemented other compliance systems on a systematic basis, but merely failed to describe such reviews or systems in its written supervisory procedures. For example, _____ introduced and testified to the Compliance Inspection Report and the review and response thereto as further evidence of satisfactory written supervisory procedures.⁷⁰ Although these documents establish that some type of a review was done by the Compliance Department on or about December 11, 1995, there is no evidence that Respondent conducted such reviews on a regular and systematic basis. Indeed, Respondent's Assistant Compliance Director's cover memorandum that accompanied the report states "[o]ur overall reaction to the department

⁶⁹ See, e.g., CX-15 at 4, 5, 6, and 8.

⁷⁰ See RX-9 and RX-10, respectively, and Tr. at 237-38 and 261-62.

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procedures was very favorable, especially in light of the fact that the department has never had such a review.⁷¹

The Hearing Panel finds that the December 11, 1995 Compliance Department review does not constitute the establishment, maintenance, and enforcement of written supervisory guidelines within the meaning of NASD Conduct Rule 3010. The Hearing Panel also finds that the other systems and procedures described by _____⁷² either were insufficient to ensure compliance with the trade reporting rules and the Limit Order Protection Interpretation,⁷³ or were not part of a regular supervisory system to monitor for compliance with the Association's trade reporting rules or Limit Order Protection Interpretation.⁷⁴ Accordingly, the Hearing Panel finds that Respondent's written supervisory guidelines were deficient and did not comply with NASD Conduct Rules 2110 and 3010.

⁷¹ RX-9 at 1 (emphasis added). In addition, Respondent's witness _____, who participated in the compliance audit, admitted that no audit was conducted of the firm's compliance with the Limit Order Protection Interpretation or the Association's trading rules. Tr. at 270-71. And _____ testified that his directions to managers concerning the audit review did not address documentation or review for compliance with the Association's trade reporting rules or the Limit Order Protection Interpretation. See RX-10 at 5 and Tr. at 237-39.

⁷² See page 14 and nn. 45-47, infra. See also Tr. at 246-50.

⁷³ For example, _____ testified that part of Respondent's undocumented supervisory system for limit order protection compliance included an "alert" whenever a trader executed a triggering trade that required execution of the customer limit order within the Limit Order Protection Interpretation. Tr. at 252. As testified to by _____, however, this system allowed the trader to acknowledge the alert, not execute the customer limit order, and then proceed to execute another transaction in another security that was not the subject of the alert. Tr. at 255. In addition, _____ was not sure whether the system alerted any managers or compliance person when a trader ignored an alert, and no exception reports were provided by Respondent that identified situations in which traders had disregarded such alerts. Id. at 256.

⁷⁴ See, e.g., Tr. at 246-50.

IV. Sanctions

A. Cause One: Customer Limit Order Protection Interpretation

Respondent admitted a violation of Cause One of the Complaint.⁷⁵ The violation involved one (1) transaction out of a total sample of seventy-seven (77) limit orders.⁷⁶ The transaction was a short sale of 2,000 shares for which the firm traded ahead of the customer on a total of 800 shares.⁷⁷ The customer received execution subsequently for 100 shares.⁷⁸

The 1996 NASD Sanction Guidelines ("1996 Guidelines") recommend that the Hearing Panel consider the following relevant factors in determining sanctions⁷⁹: (1) prior disciplinary history of Respondent; (2) number, size, and character of related transactions; (3) absence of reasonable explanation; (4) whether the violation was negligent, intentional, or reckless; (4) adequacy of supervisory procedures and controls at the time of violation, including training/educational initiatives; (6) demonstrated new corrective measures or controls to prevent recurrence; and (7) other mitigating or aggravating factors.⁸⁰ In addition, in determining

⁷⁵ Answer at ¶5. Cause I alleges a violation of NASD Conduct Rule 2110 and IM-2110-2.

⁷⁶ See Tr. at 39.

⁷⁷ CX-3 and Tr. at 46-8.

⁷⁸ CX-1, CX-4 and Tr. at 50-51, 164-65.

⁷⁹ 1996 NASD Sanction Guidelines at 30 (1996). All references herein are to the 1996 version of the NASD Guidelines. Although the 1998 Sanction Guidelines are applicable to all decisions issued after May 15, 1998, the Hearing Panel decided to apply the 1996 Guidelines since the Parties specifically addressed the 1996 Guidelines both at the hearing and in their post-hearing briefs. For the violations found here, there is no difference between the sanctions imposed by the Hearing Panel under the 1996 Guidelines and the sanctions that may be imposed under the 1998 Guidelines.

⁸⁰ The 1996 Guidelines state that in the absence of prior history of a violation, it is appropriate for the Panel "to consider lesser sanctions when mitigating circumstances are evident." Id. at 30, n. 2. The 1996 Guidelines recommend fines ranging from \$1,000 to \$100,000, but state that for the first violation, a lesser sanction may be considered where mitigating circumstances are evident. Id. at 30, n. 2.

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appropriate sanctions, the Hearing Panel recognizes that the purpose of the Limit Order Protection Interpretation is to ensure investor protection and enhance market quality.⁸¹

In this case there is no evidence of any prior history of violations by Respondent in connection with the Customer Limit Order Protection Interpretation.⁸² Further, the violation involved only one (1) transaction out of a total sample of seventy-seven (77) limit orders. The customer, however, did not receive execution until two days after the triggering trade,⁸³ Respondent traded 800 shares "ahead" of the customer for its own account, and the customer ultimately only received execution for 100 shares when he was entitled to an execution of 800 shares.⁸⁴

In explaining the circumstances which gave rise to the violation, _____ testified that there were recurring problems with Respondent's conversion to a new computerized trading system ("Brass").⁸⁵ Under the new Brass system, for example, cancelled and rebilled trades were not passed through the audit file to identify limit order trades that needed to be executed.⁸⁶ At the time of the conversion, however, Respondent was aware that it was only the second broker-dealer ever to use this version of Brass; the first customer was a broker-dealer that

⁸¹ NASD Conduct Rule IM-2110-2.

⁸² See CX-16 and Tr. at 77-79. CX-16 is an abstract of Respondent's disciplinary history from CRD.

⁸³ The customer did not receive execution contemporaneously to the time at which Respondent traded at a price equal to or better than the customer limit order. See CX-1, 2,3, and 4 and Tr. at 43-51.

⁸⁴ Id.

⁸⁵ Tr. at 151-53, 160-167 and RX-12 and RX-14. The period of the conversion was March 1996 through October 1996. Tr. at 160.

⁸⁶ Tr. at 165.

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executed a very limited number of trades.⁸⁷ Thus, although there is no evidence that the violation was intentional or reckless, under the circumstances, Respondent should have taken appropriate steps to ensure that its trading system would and did operate in a manner consistent with its regulatory obligations.

_____ testified that once the defect in the Brass system was detected, steps were taken to correct the problem.⁸⁸ No evidence, however, was presented as to when this defect in the Brass system was corrected and the record suggests that the violation actually first was discovered during the examination that resulted in the Complaint.⁸⁹ Moreover, _____ testified that an updated version of Respondent's written supervisory manual, dated September 1997, still was in draft form as of the date of the hearing.⁹⁰

On balance, there are no mitigating factors to be considered which support a lesser fine than that suggested by the NASD Sanction Guidelines for a first violation. Thus, the Hearing Panel determines that a fine of \$1,000.00 is an appropriate sanction.

⁸⁷ Tr. at 146-7 and 239-42.

⁸⁸ Tr. at 166-67. See also Tr. at 160-164.

⁸⁹ See, e.g., Tr. at 46-51 and 167.

⁹⁰ Tr. at 269. As noted, this document (RX-18) identifies those persons responsible for monitoring compliance with the Limit Order Protection Interpretation and the Association's trade reporting rules and the steps to be taken to ensure compliance. See, e.g., id. at 14. There was no evidence presented at the hearing, however, that this document has been distributed to members of the firm and that the compliance procedures described therein have been implemented.

B. Trade Reporting and Record-keeping Violations

Enforcement argues that Respondent committed 18 separate and distinct violations⁹¹ relating to trade reporting. Accordingly, in considering sanctions, Enforcement urges the Panel to consider the statement in the NASD Sanction Guidelines that “cases involving numerous violations should warrant high sanctions.”⁹² In cases, however, where multiple trade reporting violations such as those found here all arise from a single examination, the Panel need not impose higher sanctions.⁹³

1. Cause Two -- Failure to Report One OTC Transaction to ACT

Respondent admitted a violation of Cause Two.⁹⁴ This violation involved the failure to report one transaction of 307 shares in an inactively traded non-Nasdaq security commonly referred to as a "pink sheet" security for the trade date of April 18, 1996, in violation of NASD Marketplace Rule 6620(a).⁹⁵

⁹¹ Tr. at 22. In its post-hearing brief, Enforcement alleged 16 separate violations of the Association’s trade reporting rules. Enforcement’s Br. at 20. Cause Four alleges a violation both of NASD Marketplace Rule 4632(f) [a trade reporting violation] as well as NASD Conduct Rule 3110 [a record-keeping violation]. The number of trade reporting violations, whether 16 or 18, appear to be the cumulative violations alleged in Causes Two, Three, Four and Five of the Complaint. Because the violations alleged in Cause Three are closely related to those alleged in Cause Four, they have been considered jointly by the Hearing Panel in determining sanctions.

⁹² See Tr. at 23. With respect to the trade reporting violations, Enforcement proposes that the Panel consider as aggravating factors the number of separate and distinct violations, the negative impact on market price discovery data, the fact that the size of the violative transactions was as high as 5,000 shares, and that Respondent has a prior history of trade reporting violations. Enforcement’s Br. at 21. The twelve (12) relevant considerations for trade reporting violations are found at page 55 of the 1996 Guidelines and, to the extent applicable, have been considered by the Hearing Panel in determining sanctions for the violations set forth in Causes Two, Three, Four and Five of the Complaint. In addition, with respect to Cause Four, the Hearing Panel also has considered the factors for record-keeping violations at page 40 of the 1996 Guidelines.

⁹³ The 1996 Guidelines (at p. 55) recommend fines ranging from \$1,000 to \$100,000.

⁹⁴ Answer at ¶9.

⁹⁵ Tr. at 52-57 and 169-171.

As an explanation for the failure and a mitigating factor, _____ testified that Respondent was undergoing a conversion to a new computer system (Brass) which did not automatically report inactively traded stocks as required by ACT.⁹⁶ As to new corrective measures or controls to prevent future violations, _____ testified that new exception reports have been developed to alleviate the recurrence of this error.⁹⁷

While the conversion to Brass does not excuse Respondent's compliance with the Association's trade reporting rules, the violation alleged in Count Two appears to be the result of a software error. There are no aggravating factors to be considered and the size of transaction was relatively small. Accordingly, under the circumstances, the Hearing Panel finds that a letter of caution is an appropriate sanction.

2. Cause Three -- Failure to Properly Report Aggregated Trades

Cause Four -- Failure to Properly Designate Order Tickets as Aggregated Trades

Respondent admitted a violation of Cause Three and denied the allegations of Cause Four.⁹⁸ For the reasons stated above, the Hearing Panel found a violation of Cause Four.⁹⁹

The violation alleged in Cause Four is discussed in detail previously in this decision. The violation alleged in Cause Three was failure to identify the corresponding aggregated transaction report in a manner directed by the Association in violation of NASD Marketplace Rule 4632(f). In other words, Respondent failed to designate an aggregated sales transaction with a ".B"

⁹⁶ Tr. at 170-71.

⁹⁷ Tr. at 262 and RX-23 at 5.

⁹⁸ Answer at ¶¶12, 15.

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modifier, but, instead, reported the transaction to ACT as one sale.¹⁰⁰ Enforcement offered no evidence to establish that Respondent's failure to indicate the aggregation of two transactions had any adverse impact on market price discovery data for the security involved. There also is no evidence to suggest that the violation was intentional. As a mitigating factor, Respondent proffered documents to demonstrate that new exception reports have been developed which should alleviate recurrence of this error¹⁰¹ and that new reports and procedures have been and continue to be developed.¹⁰²

There are no aggravating factors and the size of the transaction at issue was relatively small. Moreover, as discussed more fully above, as to Cause Four, Rule 4632(f) does not appear to reflect the realities of trading in today's electronic environment. Thus, the Hearing Panel finds that a letter of caution is an appropriate sanction for violations of Causes Three and Four of the Complaint.

3. Cause Five -- Failure to Timely Report Transactions on Form T

Respondent has admitted the violations alleged in Cause Five.¹⁰³ The violations relate to the time period of March 29 through April 22, 1996, and involve Respondent's failure to report weekly to the Market Regulation Department, on Form T, last sales reports for 14

⁹⁹ Since the violations alleged in Causes Three and Four arise from the same transaction, the Hearing Panel has considered them collectively in determining sanctions.

¹⁰⁰ Tr. at 12, 65 and CX-10 and CX-11.

¹⁰¹ Tr. at 262 and RX-23 at 4.

¹⁰² RX-18 at 16 and RX-19 at 20. As noted in this decision, however, _____ testified that RX-18 still was in "draft" form as of the date of the Hearing.

¹⁰³ Answer at ¶19; Tr. at 167-68.

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transactions in Nasdaq National Market Securities that were not transmitted through ACT.

This conduct violated NASD Marketplace Rule 4632(a).¹⁰⁴

The Hearing Panel considers these trading reporting violations to be more serious than those alleged in Causes Two, Three, and Four of the Complaint. _____ did not offer any reason for the failure to report on a timely basis, other than to testify that Respondent “screwed up” and there was a “mix-up and a misunderstanding.”¹⁰⁵ The failure to report on a timely basis extended over a two week period and the number of shares involved in several of the transactions were quite large.¹⁰⁶ Moreover the applicable Rule clearly states “[a]ll members shall report weekly * * *.”¹⁰⁷

NASD Marketplace Rule 4632 is directed at the very purpose of accurate and timely trade reporting. As the SEC stated in its 21(a) Report:¹⁰⁸

Timely trading reporting * * * [is] essential to providing investors * * * with an accurate picture of Nasdaq market activity.

* * *

Accurate and timely transaction reports provide critical information to investors, issuers, and brokers and dealers trading Nasdaq securities * * *. Trade reporting problems also hamper the ability of investors, firms, and regulators to monitor broker-dealer compliance with a variety

¹⁰⁴ Tr. at 67-68 and 167-69.

¹⁰⁵ Tr. at 168.

¹⁰⁶ See CX-14 at 1. (Respondent’s Form T dated April 30, 1996). CX-14 reflects that one transaction involved 2,300 shares and another transaction involved 5,000 shares.

¹⁰⁷ NASD Marketplace Rule 4632 at ¶ (a)(5).

¹⁰⁸ Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the Nasdaq Stock Market at 34, 35 (August 8, 1996).

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of investor protection rules, including the limit order protection interpretation * * *.

The Hearing Panel recognizes that the failure to report the transactions over a two week period, in conjunction with the large number of shares involved in several of the transactions,¹⁰⁹ may have had a negative impact on market price discovery data. Enforcement, however, offered no evidence that _____ reporting failure had any impact on price discovery. Complainant did offer evidence that Respondent had a prior history of trade reporting violations.¹¹⁰ The Hearing Panel did not find the three reported incidents to be relevant or timely with respect to its consideration of sanctions.

Even though there was no evidence that Respondent's trade reporting failures were intentional, in the absence of any mitigating factors, and given the period of noncompliance and the number of shares involved in several of the transactions, the Hearing Panel determines that a fine of \$2,000.00 is an appropriate sanction.

C. Cause Six -- Written Supervisory Guidelines

The Hearing Panel found that Respondent violated NASD Conduct Rules 2110 and 3010 by failing to establish, maintain, and enforce adequate written supervisory guidelines reasonably designed to deter and detect violations of the Limit Order Protection Interpretation and the Association's trade reporting rules. The deficiencies in Respondent's written supervisory guidelines are discussed in detail in this decision. In determining the appropriate sanctions, the Hearing Panel has considered the relevant factors set forth in the NASD Guidelines.¹¹¹

¹⁰⁹ See n. 106, *infra*.

¹¹⁰ CX-16 at 1, 2, and 5.

Enforcement contends that the Hearing Panel should consider that Respondent was sanctioned for other supervisory violations.”¹¹² Respondent argues that the two prior violations relate to sales supervision and that one of the previous allegations involving supervision does not appear to involve any findings with respect to written supervisory procedures.¹¹³

As mitigating factors, Respondent argues that procedures and controls reflected in its written supervisory guidelines represent only a portion of its supervisory procedures and the fact that Respondent was upgrading its computer system to reflect the changing regulatory environment should be taken into account.¹¹⁴

The Hearing Panel finds that Respondent’s prior disciplinary history is neither an aggravating nor a mitigating factor for purposes of determining sanctions. Moreover, although the Hearing Panel is aware of the inherent problems in conversion to a new computer system, for the reasons discussed in finding a violation with respect to Cause Four and, also, the sanctions with respect to Cause One, the Hearing Panel finds that such conversion does not excuse the deficiencies in Respondent’s written supervisory guidelines.¹¹⁵ The absence in the written supervisory guidelines of adequate procedures to be followed by supervisory personnel to ensure compliance with the Limit Order Protection Interpretation and the Association’s trade reporting rules, which were in place for the period from October 1995 through March 11,

¹¹¹ See 1996 Guidelines at p. 53. The Guidelines recommend fines ranging from \$5,000 to \$25,000.

¹¹² Enforcement’s Br. at 22. See CX-16 at 3 and 4.

¹¹³ Respondent’s Br. at 21-2.

¹¹⁴ Id. at 22.

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1996, is unrelated to the problems Respondent experienced with conversion to the Brass trade reporting system commencing in March 1996.¹¹⁶ Further, although the evidence demonstrates that Respondent has made efforts to develop new supervisory procedures,¹¹⁷ these procedures still were in draft form at the time of the hearing which was more than a year after the subject examination had been completed.¹¹⁸

The Hearing Panel has taken into consideration that the purpose of the NASD Sanction Guidelines is remediation, not punishment. To this end, the Sanction Guidelines seek to impose remedial actions to protect the public from harm and to discourage future misconduct or noncompliance with the Association's rules and regulations. This is not a case where Respondent intentionally violated NASD Conduct Rules 2110 and 3010 by failing to develop, establish and maintain written supervisory guidelines designed to ensure compliance with the Association's trade reporting rules and the Limit Order Protection Interpretation. Moreover, the testimony of _____ demonstrates that Respondent was making some effort to monitor compliance during the conversion to the Brass system and that there was some oversight of the

¹¹⁵ This especially is true since Respondent was put on notice by the Association, as were other member firms, both in April and July 1995 (see CX-15 at 27 and RX-6 at 2 and 6), well before the period covered by the examination, that it was required to monitor and audit for trade reporting compliance.

¹¹⁶ _____ testified that installation of the new system commenced on March 11, 1996 which only was one month prior to the end of the seven month period of October 1995 through April 1996 that comprised the examination of Respondent's written supervisory procedures and system. Tr. at 41 and 160. In addition, Respondent cannot rely on this conversion to excuse a clear violation of NASD Conduct Rule 3010(b)(2) which requires it to include in its written supervisory guidelines the titles, registration status, and location of required supervisory personnel and the responsibilities of each such person.

¹¹⁷ RX-18.

¹¹⁸ At the hearing Respondent did not offer any document to reflect exactly what changes it had made to its written supervisory procedures, nor did it offer any testimony that a revised supervisory manual had been distributed to members of the firm. Although Respondent identified documents on its Exhibit List which pre-date RX-18, they were not offered into evidence and are not part of the record in this proceeding.

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trading department by _____.¹¹⁹ While these factors do not excuse the deficiencies of Respondent's written supervisory guidelines, they have been taken into consideration in determining sanctions.

Taking into consideration all of the circumstances discussed in this decision, the Hearing Panel determines that a fine of \$5,000.00 is an appropriate sanction for the violations of NASD Conduct Rules 3010 and 2110 alleged in Cause Six of the Complaint.

Accordingly, having considered all of the evidence submitted by the Parties,¹²⁰ Respondent will receive a letter of caution (for the violations alleged in Causes Two, Three and Four) and is fined \$8,000 (\$1,000 for the violation alleged in Cause One, \$2,000 for the violation alleged in Cause Five, and \$5,000 for the violation alleged in Cause Six). The costs of the hearing (\$1698.90) also are assessed against Respondent.

These sanctions shall become effective on a date set by the Association, but not before the expiration of 45 days after the date of this decision.

Hearing Panel

By _____
Ellen A. Efros
Hearing Officer

¹¹⁹ Thus, this is not the type of egregious situation that was presented in the Bryant case where there was no evidence of any supervisory procedures, written or otherwise. See Bryant, 1994 SEC LEXIS at *19 and n. 54.

¹²⁰ All of the Parties' arguments have been considered by the Hearing Panel and are rejected or sustained to the extent they are inconsistent or consistent with this decision.