

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

In the Matter of the Continued Association

of

X

as an

Investment Company Variable Contracts  
Representative

with

Sponsoring Firm 1

and

Sponsoring Firm 2

**Redacted Decision**

Notice Pursuant to

Rule 19h-1

Securities Exchange Act

of 1934

SD Decision No. 02009

On November 13, 2001, Sponsoring Firm 1 and Sponsoring Firm 2 (together, "the Applicants") completed a Membership Continuance Application ("MC-400" or "the Application") requesting permission for X<sup>1</sup>, a person subject to a statutory disqualification but currently associated with the Applicants as an investment company and variable contracts representative ("Series 6 representative"), to continue to associate with the Applicants as a Series 6 representative.<sup>2</sup> In May 2002, a subcommittee ("Hearing Panel") of the Statutory

<sup>1</sup> The names of the Statutorily Disqualified individual, the Sponsoring Firms, the Proposed Supervisor, and other information deemed reasonably necessary to maintain confidentiality have been redacted.

<sup>2</sup> X has been associated with Sponsoring Firm 1 and Sponsoring Firm 2 as an investment company and variable contracts representative since July 1989. As set forth in detail below, NASD was unaware of X's statutory disqualification status until he filed an amendment to his Uniform Application for Securities Industry Registration or Transfer ("Form U-4") in May 2001, when he considered registering as a general securities representative and taking the Series 7 examination. X testified at the hearing that he is no longer pursuing a Series 7 registration. The Applicants are aware, however, that if X later wishes to pursue a Series 7 registration, they must file a new MC-400 application. In that event, both X and the Proposed Supervisor recognize that X must be supervised by a person who is registered as a general securities principal (Series 24). At present, X's Proposed Supervisor is not a general securities principal.

Disqualification Committee of NASD held a hearing on the matter. X appeared and was accompanied by his Proposed Supervisor, a Managing Director for Sponsoring Firm 1 and Sponsoring Firm 2. LL appeared on behalf of the Department of Member Regulation of NASD.

A. X's Disqualifying Event

X is statutorily disqualified because he entered a guilty plea in September 1994 in the 14th Judicial District Court of State 1 to the crime of driving under the influence of intoxicating liquor ("DUI"). This conviction was a felony offense because it was X's third DUI – he was previously convicted of a DUI in October 1984 and on October 1987. For the felony offense, the court sentenced X to 12 months in jail and three years' probation, and revoked his driver's license. X served 10 months of his jail term in a work release program. He received a discharge from probation in September 1997, and his driving privileges were reinstated in October 2000.

B. Background Information

1. X

X was first registered in the securities industry as a Series 6 representative with Sponsoring Firm 1 and Sponsoring Firm 2 in May 1992. He also qualified by passing the Uniform Securities Agent State Law Examination (Series 63) in August 1992. X has been employed by the Applicants since July 1989. Prior to that time, he was not employed in the financial services industry.

X did not disclose the felony charge and conviction on his Form U-4 when it occurred in 1994. He testified that when the conviction occurred, he informed his manager of the event. The manager stated that because the conviction was not financial-related, X need not disclose it. X testified at the hearing that his manager and his co-workers were well aware of the conviction because he had to make various arrangements with them to continue to work at Sponsoring Firm 1 and Sponsoring Firm 2 during his 10 months on the work release program. Moreover, X stated that his manager and colleagues knew that he had lost his driving privileges and had to be driven to business appointments by his secretary.

X has had nine customer complaints filed against him since 1989, all of which were insurance related and did not involve the mishandling of money or any securities transactions. No cash settlements were paid. Seven of the customer complaints were service related – Sponsoring Firm 2 responded to the complaints by providing the services requested and no action was taken against X. The remaining two customer complaints were denied in writing by Sponsoring Firm 2 and did not proceed further.

We are not aware of any other regulatory actions taken against X.

2. Sponsoring Firm 1

Sponsoring Firm 1 has been a member of NASD since 1969, and it is classified as a broker-dealer selling variable life insurance and annuities in addition to other non-securities products. Sponsoring Firm 1 has 68 offices of supervisory jurisdiction and 669 branch offices, and it employs 1,157 registered principals, 9,715 registered representatives, and a total of approximately 46,000 employees. These numbers also reflect substantial overlap with Sponsoring Firm 2, as the employees and the offices are often affiliated with both Sponsoring Firm 1 and Sponsoring Firm 2.

Sponsoring Firm 1's 1997 and 2001 routine examinations resulted in the issuance of Letters of Caution ("LOCs"). The 1997 LOC cited Sponsoring Firm 1's failure to provide timely notice to the NASD District Office of a merger between Sponsoring Firm 1 and another life insurance company. The 2001 LOC cited a failure to report timely an employee's settlement with a customer, a failure to report timely a customer's complaint, and failure to file timely Uniform Termination Notices for Securities Industry Registration ("Forms U-5"). The record shows that Sponsoring Firm 1 responded to these LOCs and corrected the deficiencies noted.

Sponsoring Firm 1's 2002 routine exam has commenced but it is not yet completed.

3. Sponsoring Firm 2

Sponsoring Firm 2 has been a member of NASD since 1984, and it is classified as a broker-dealer. Sponsoring Firm 2 has 59 offices of supervisory jurisdiction and 662 branch offices, and it employs 1,131 registered principals, 9,512 registered representatives, and a total of approximately 46,000 employees. As mentioned previously, these numbers also reflect substantial overlap with Sponsoring Firm 1, as the employees and the offices are often affiliated with both Sponsoring Firm 1 and Sponsoring Firm 2.

Sponsoring Firm 2's 1999 routine examination and 2000 alternative municipal examination (conducted by NASD) were filed without action ("FWA"). The 2001 routine examination resulted in the issuance of an LOC for deficiencies in Sponsoring Firm 2's special reserve account and failure to evidence completion of a continuing education program. Sponsoring Firm 2 responded to the LOC and corrected the deficiencies noted.

Sponsoring Firm 2's 2002 routine exam has commenced but it is not yet completed.

Sponsoring Firm 1 and Sponsoring Firm 2 state in the Application that they are currently involved in approximately seven legal proceedings brought by individual retail clients and one broker-dealer. The Applicants state that the retail claims involve various sales practice allegations including unsuitable recommendations, private securities transactions, and misrepresentations. The broker-dealer case involves allegations of non-disclosure. The dollar amounts of the claims range from approximately \$10,000 to \$110,000 for the retail cases. The plaintiff in the broker-dealer case is seeking \$1 million.

We are not aware of any other complaints, disciplinary proceedings, or arbitrations against the Applicants. Sponsoring Firm 1 and Sponsoring Firm 2 are not members of any other self-regulatory organization. The Applicants employ one other statutorily disqualified individual, who was the subject of an Order of Permanent Injunction filed in 1973. He currently is not subject to routine SD examinations, is employed at a location separate from X, and is supervised by a principal other than the Proposed Supervisor.

C. X's Proposed Business Activities and Supervision

The Applicants propose that X will continue to be employed as a Series 6 representative in his one-person office located in State 1. The Proposed Supervisor will be X's responsible supervisor. The Proposed Supervisor is a managing director for Sponsoring Firm 1 and Sponsoring Firm 2 and he is located in State 1, approximately 45 miles from X's office. The supervisory plan proposed by the Applicants includes a provision that the Proposed Supervisor will travel to X's office, unannounced, every other week to meet with him and review business transactions. On the alternate weeks, X will travel to the Proposed Supervisor's office, where the Proposed Supervisor will conduct his review.

The Proposed Supervisor has been employed by Sponsoring Firm 1 and Sponsoring Firm 2 since November 1993. He has been an investment company variable contracts representative since 1994, an investment company variable contracts principal since 1998, and a general securities representative since 2001.

The Proposed Supervisor has had two customer complaints filed against him. Both were insurance and service related. The requested service was later rendered by the Applicants and no action was taken against the Proposed Supervisor. We are not aware of any other regulatory action against the Proposed Supervisor.

D. Member Regulation's Recommendation

Member Regulation recommends that X's continued association with Sponsoring Firm 1 and the Sponsoring Firm 2 be approved, subject to the supervisory terms and conditions that are set forth below.

E. Discussion

After carefully reviewing the entire record in this matter, we approve Sponsoring Firm 1 and Sponsoring Firm 2's Application to continue to employ X as an investment company variable contracts representative subject to the terms and conditions set forth below.

In reviewing this type of application, we have considered whether the particular felony at issue, examined in light of the circumstances related to the felony, and other relevant facts

and circumstances, creates an unreasonable risk of harm to the market or investors.<sup>3</sup> For the reasons set forth below, we conclude that X's continued participation in the securities industry will not present an unreasonable risk of harm to the market or investors.

We acknowledge that the conduct that resulted in X's disqualification was very serious. We note, however, that X committed the offense almost eight years ago, and he was released from probation more than four years ago.<sup>4</sup> Moreover, the record shows that X has taken appropriate measures and has successfully addressed the problems that led to his felony conviction by seeking rehabilitation through his continuing association with Alcoholics Anonymous.<sup>5</sup>

We also note that the felony conviction did not involve securities or financial products, nor did the court find that X acted dishonestly. Further, X has no intervening misconduct and the Proposed Supervisor is a qualified investment company variable contracts principal with no formal or informal regulatory history. Moreover, Sponsoring Firm 1 and Sponsoring Firm 2 have been members of NASD since March 1984 and July 1969, respectively, and neither firm has a significant disciplinary history that raises regulatory concern.

In reaching this determination, we have focused on two areas of concern in this Application. First, X failed to amend his Form U-4 in a timely manner following the 1994 DUI felony charge and conviction. Second, the Applicants' supervisory plan proposes that the Proposed Supervisor will be supervising X from an off-site location.

With regard to the failure to disclose the DUI felony charge and conviction on the Form U-4, we are convinced that X fully discussed the gravity of the situation with his former supervisor. As X testified, such complete disclosure was necessary to address the questions of his continuing employment while subject to a work release program and the deprivation of his driver's license. We also find that X relied upon the advice of his former supervisor, who stated that disclosure was not necessary unless the underlying offense was financial related. X did not attempt to conceal the consequences of his misconduct; he testified that he had openly discussed his past substance abuse problem and the fact that he had served time in jail. Although X should have taken the responsibility to amend his Form U-4, we find that his failure to do so was based on incorrect advice from his supervisor. X has continued to be employed in the

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<sup>3</sup> See Frank Kufrovich, Exchange Act Rel. No. 45437, 2002 SEC LEXIS 357, at \*16 (Feb. 13, 2002) (upholding NASD's denial of a statutory disqualification applicant who had committed non-securities related felonies "based upon the totality of the circumstances" and NASD's explanation of the bases for its conclusion that the applicant would present an unreasonable risk of harm to the market or investors).

<sup>4</sup> The offense took place in 1994 and the probation was terminated in 1997.

<sup>5</sup> X testified that he has not had an alcoholic drink since June 1994.

securities industry since June 1994 without incident. That fact, combined with the supervisory procedures listed below, lead us to conclude that he should be permitted to continue with Sponsoring Firm 1 and Sponsoring Firm 2.

As to the off-site supervision by the Proposed Supervisor, we find that the proposed supervisory plan is comprehensive and addresses our concerns. That plan, set forth below, includes weekly, in-person visits between X and the Proposed Supervisor for discussion of all business transactions. Every other week, those visits will be unannounced and will be conducted in X's office. On the alternate weeks, X will travel to the Proposed Supervisor's office in State 1.<sup>6</sup> At the hearing, the Proposed Supervisor testified that he fully understood the magnitude of the responsibility that he was undertaking in supervising a statutorily disqualified individual such as X. Given the nature of X's felony offense, and the number of years that he has been employed successfully by Sponsoring Firm 1 and Sponsoring Firm 2, we conclude that the following supervisory conditions will provide the enhanced compliance measures necessary to monitor X's activities:

1. The Proposed Supervisor will travel from State 1 to meet with X every other week in X's office in State 1. These visits will be unannounced. On the alternate weeks, X will travel to the Proposed Supervisor's office in State 1 where the Proposed Supervisor will conduct his review.
2. The Proposed Supervisor will review all business transactions on a weekly basis.
3. The Proposed Supervisor will initial X's case files and review his sales material on a weekly basis.
4. All new accounts for the various products that X can sell pursuant to his Series 6 registration will be sent (via U.S. mail) to the Proposed Supervisor's attention for approval.
5. X will not act as a supervisor.
6. X will not maintain discretionary accounts.
7. All complaints pertaining to X, whether written or verbal, will be immediately reviewed by the Proposed Supervisor and forwarded to the Compliance Director. Documents pertaining to these complaints should be kept segregated for ease of review.

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<sup>6</sup> As the Proposed Supervisor testified at the hearing, it would not be practical for all visits to be unannounced because X often conducts business on the road and therefore might not be in his office if the Proposed Supervisor always attempted to arrange a surprise visit.

8. X will be subject to an annual compliance inspection.
9. The Proposed Supervisor will review X's outgoing and incoming written correspondence at the time they are either sent or received. All outgoing correspondence will be reviewed and approved by the Proposed Supervisor.
10. For the duration of X's statutory disqualification, Sponsoring Firm 1 and the Sponsoring Firm 2 must obtain prior approval from Member Regulation if they wish to change X's responsible supervisor from the Proposed Supervisor to another person.
11. Both firms will amend their supervisory procedures to specify who is responsible for supervising X, and the supervisory procedures will include the special supervisory program set forth above.

Thus, we conclude that X's continued employment in the industry will not create an unreasonable risk of harm to the market or investors.

NASD certifies that: 1) X meets all applicable requirements for the proposed employment; 2) the Applicants are not members of any other self-regulatory organization; and 3) X and the Proposed Supervisor have represented that they are not related by blood or marriage.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the continued association of X as a Series 6 representative with Sponsoring Firm 1 and Sponsoring Firm 2 will become effective within 30 days of the Commission's receipt of this notice, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President and  
Corporate Secretary