

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of
the Continued Association of

X

as a

General Securities Representative

with

The Sponsoring Firm

Redacted Decision

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

SD01001

On June 8, 2000, a member firm ("the Sponsoring Firm" or "the Firm") submitted a Membership Continuance Application ("MC-400" or "the Application") to permit X¹, a person subject to a statutory disqualification, to continue to associate with the Firm as a general securities representative. In September 2000, a subcommittee ("Hearing Panel") of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by his proposed supervisor, the manager of the Firm's home office ("the Proposed Supervisor"). BA appeared on behalf of NASD Regulation's Department of Member Regulation ("Member Regulation").

X's Statutorily Disqualifying Event and Background. X is subject to a statutory disqualification, under Section 3(a)(39)(F) of the Securities Exchange Act of 1934 ("Act") and Article III, Section 4(g) of the NASD By-Laws, as the result of a 2000 final judgment by consent entered against X by a United States District Court ("the Consent Judgment"). The Consent Judgment was based on a 1997 complaint filed by the Securities and Exchange Commission ("the Commission") that alleged that X and various other defendants had engaged in insider trading in the securities of Firm A. The complaint alleged that a director of Firm A (who had used X as his stock broker for over 25 years) tipped X about a proposal by Firm B to acquire Firm A. The complaint further alleged that, while in possession of this material, nonpublic information, X purchased 1,600 shares of Firm A for his own account; opened new securities accounts (using false information) for the director of Firm A and his relatives and

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

placed orders for them to purchase Firm A stock; and solicited and executed trades in Firm A stock for 18 customer accounts for which he received commissions. X allegedly received profits of \$7,900 in his own account, and his clients received profits of \$29,512.50.

The Consent Judgment permanently enjoined X from future violations of Section 10(b) of the Securities Exchange Act of 1934 ("the Act") and Rule 10b-5 thereunder ("the Permanent Injunction" or "the PI"). X was also ordered to pay \$53,226.49 plus interest in disgorgement, but based on X's sworn representations in a Statement of Financial Condition, payment of all but \$5,000 of the disgorgement was waived. X paid the \$5,000 in June 2000.

X has been a registered representative since 1963. He has been registered with the Sponsoring Firm since May 1996. Prior to that date, he was registered with two other NASD member firms. He has no other regulatory or disciplinary history.

The Sponsoring Firm. The Sponsoring Firm became a member of the Association in 1958.² The Firm has 16 branch offices, and it employs 10 registered principals and 90 registered representatives. The Sponsoring Firm is engaged in a general securities business and it clears through Firm C on a fully disclosed basis.

The routine examination of the Sponsoring Firm for the year 2000 has been assigned, but not yet conducted. The field work for the 1999 routine examination of the Firm is complete, but no action has been taken to date. The Firm also has had the following disciplinary history in the last 10 years:

In 1999, State 1 issued an administrative complaint against the Sponsoring Firm and three of its employees alleging the following violations: mismarking of new account documentation, mismarking of trade tickets and confirmations, use of an unregistered agent, recommending unsuitable investments, failure to supervise, failure to enforce the broker-dealer's written procedures, and engaging in dishonest or unethical business practices. The complaint is pending.

The Sponsoring Firm was the subject of an ex-parte cease and desist order issued by State 2 in 1998 for selling securities in State 2 without being registered. State 2 also alleged that the Sponsoring Firm failed to supervise one of its agents who sold securities in a trading account without the investor's authorization and that the Sponsoring Firm failed to respond to the investor's complaint.

In 1998, an NASD District Business Conduct Committee ("DBCC") accepted a Letter of Acceptance, Waiver and Consent ("AWC") from the Sponsoring Firm in which the Firm was found to

² At the hearing, the Proposed Supervisor explained that the Firm was founded in 1958 under a different name and that since 1996 it has been "doing business as" the Sponsoring Firm.

have violated MSRB Rules G-8 and G-36 by failing timely to submit to the MSRB final official statements required by Rule G-36 and by failing to maintain a record of the dates that the statements were mailed to the MSRB or received from the issuer. For this misconduct, the Firm was censured and fined \$4,000. The fine was paid in 1998.

In 1998, the Sponsoring Firm consented to a cease and desist order issued by State 3, agreeing to pay an administrative assessment of \$7,500 and investigative costs of \$3,000. In 1997, the Sponsoring Firm applied for registration with State 3 representing that no offers or sales had been made by the Sponsoring Firm to State 3 customers, when in fact three State 3 residents had accounts with the Sponsoring Firm, and it had effected 230 transactions in their accounts over a four-year period. The Sponsoring Firm was found to have effected transactions with State 3 customers prior to registration and was found to have filed an application for registration that contained a false statement.

The Sponsoring Firm consented to a cease and desist order issued by State 4 in 1996 for failing to supervise one of its employees who solicited a State 4 resident to purchase stock while neither the employee nor the Sponsoring Firm was registered in State 4. The parties entered into a consent agreement in 1997.

In 1993, the NASD accepted an AWC in which the Sponsoring Firm was censured and fined \$2,500 for violating Article III, Sections 1 and 21(a) of the Rules of Fair Practice (now Conduct Rules 2110 and 3110) for misconduct by one of its registered persons. The Sponsoring Firm, acting through one of its registered persons, failed to prepare and maintain accurate stock records reflecting accurate positions; failed to reflect about 18 transactions in customer ledgers; failed to prepare a blotter or maintain other sufficient records reflecting receipts and deliveries of securities; failed to prepare a record reflecting dividends and interest received; failed to prepare a complete and accurate record reflecting securities in transfer; and failed to conduct a required quarterly securities box count. The fine was paid in 1993.

The record does not show any other complaints, disciplinary proceedings, or arbitrations against the Firm. The Sponsoring Firm does not employ any other individuals subject to statutory disqualification, and it is not a member of any other self-regulatory organization.

X's Proposed Duties and the Proposed Supervisor. The Sponsoring Firm proposes that X continue to be employed as a general securities representative in the Firm's home office in State 5. X's activities would be limited to taking and effecting orders for his own retail clients.

The Sponsoring Firm proposes that the Proposed Supervisor be responsible for supervising X. The Proposed Supervisor has been a registered representative since 1975 and a general securities principal since 1984. He is the manager of the Sponsoring Firm's home office. The Proposed Supervisor was the subject of an arbitration claim that was resolved in 1996, in which two customers

alleged that the Proposed Supervisor had failed to follow their instructions to sell stock, and they sought compensatory damages of \$24,396. The Proposed Supervisor denied the allegations, but was ordered to pay \$4,000 in damages plus filing fees.

The record shows no other disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor. X and the Proposed Supervisor are not related by blood or marriage.

Member Regulation's Recommendation. Member Regulation recommends denial of the Sponsoring Firm's application to continue to employ X as a registered representative, primarily because of the nature of the underlying misconduct, which was a recent, serious, securities-related fraud. Member Regulation also is concerned about the Sponsoring Firm's disciplinary record during the past decade, particularly the number of actions involving failures properly to supervise agents.

Discussion. After careful review of the entire record in this matter, we conclude that the Sponsoring Firm's Application to continue to employ X as a registered representative should be denied.

In reaching this conclusion, we, like Member Regulation, note that the recent incident that resulted in X's statutory disqualification involved serious, securities-related misconduct. The complaint alleged that X knew, or was reckless in not knowing, that the material, nonpublic information that had been disclosed to him was communicated in breach of a fiduciary duty, by a director of Firm A. While in possession of that knowledge, X purchased Firm A stock for his own account, opened new accounts, and solicited his clients to purchase Firm A stock, for which he received commissions. X's participation in extensive insider trading activity shows a willful disregard for important industry rules, and demonstrates that X should not be permitted to continue to be associated in the securities industry in any capacity.³ We empathize with the arguments raised about X's age (76 years old) and his failing health, but we are not persuaded by the Sponsoring Firm's Application that approval of X would be in the public interest.

We also share Member Regulation's concern with the disciplinary history of the Sponsoring Firm in the category of supervisory violations, although we note that the Proposed Supervisor is

³ At the hearing, X claimed that he had not read the Consent Judgment and that he had relied on the advice given by his pro bono attorney to sign the Consent Judgment to end the proceeding. He also denied any involvement in insider trading. X was informed that, in eligibility proceedings, no collateral attacks are permitted on the underlying event that led to the statutory disqualification. X was also informed that he could pursue his attempt to have the Consent Judgment and Permanent Injunction vacated, and that if he was successful, he would no longer be statutorily disqualified. As long as the Permanent Injunction exists, however, X is statutorily disqualified and subject to the eligibility proceedings of NASD Regulation, Inc. ("NASD Regulation").

experienced and has no disciplinary history. While we are mindful of the Firm's disciplinary record with regard to supervising its agents, we find the nature of the underlying misconduct alone sufficient to persuade us that X should not continue to be associated in the securities industry.

Based on the above, we conclude that it is not in the public interest to allow X to remain in the securities industry through association with the Sponsoring Firm in the capacity of a general securities representative.

Accordingly, the Sponsoring Firm's Application is denied. This decision is effective upon issuance; therefore X must immediately cease his securities activities.

On Behalf of the National Adjudicatory Council,

Joan C. Conley
Senior Vice President and Corporate Secretary