

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Continued Association of X as a General Securities Representative with The Sponsoring Firm
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Redacted Decision

Notice Pursuant to
Rule 19h-1
Securities Exchange Act
of 1934

Decision No. SD06001

Date: 2006

I. Introduction

On January 31, 2005, the Sponsoring Firm¹ (“the Firm”) filed a Membership Continuance Application (“MC-400” or “the Application”) with NASD’s Department of Registration and Disclosure, seeking to permit X, a person subject to a statutory disqualification, to continue to associate with the Firm as a general securities representative. A hearing was not held in this matter. Rather, pursuant to NASD Procedural Rule 9523, NASD’s Department of Member Regulation (“Member Regulation”) recommended that the Chair of the Statutory Disqualification Committee, acting on behalf of the National Adjudicatory Council, approve X’s proposed association with the Sponsoring Firm pursuant to the terms and conditions set forth below.

For the reasons explained below, we approve the Sponsoring Firm’s Application.

II. The Statutorily Disqualifying Event

X is statutorily disqualified because he failed to cause an amendment to be filed to his Uniform Application for Securities Industry Registration or Transfer (“Form U4”) to reflect that he had been charged with and convicted of misdemeanor property theft. *See* Art. III, Sec. 4(f) of NASD’s By-Laws. In 2004, NASD’s Department of Enforcement (“Enforcement”) accepted X’s submission of a Letter of Acceptance, Waiver and Consent (“AWC”) for this violation. NASD suspended X for nine months in any capacity and imposed a \$5,000 fine. The AWC also specifically provided that:

[X] understand[s] that this settlement includes a finding that . . .
[he] willfully misrepresented a material fact on a Form U-4, and that . . .

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.

this misrepresentation makes [him] subject to a statutory disqualification with respect to association with a member.

In the AWC, X consented to NASD's finding that, from May 2002, through February 2003, while he was associated with Firm One, he willfully failed to disclose his misdemeanor property theft charge and conviction. The AWC further stated that X failed to take any other steps during the relevant period to ensure that his Form U4 was amended to reflect the misdemeanor property theft charge and conviction.²

The material facts regarding the misdemeanor theft charge are as follows: 1) in May 2002, X was charged in a State 1 court with misdemeanor theft of property (stolen memory disks from a Costco store); 2) X pled nolo contendere on the same date and was convicted of misdemeanor property theft; and 3) the court placed X on summary probation for one year, ordered him to serve three days in county jail, and required him to pay \$110 in fines and restitution. X's conviction was later discharged pursuant to State 1 Penal Code 1203.4.³

III. Background Information

A. X

X first registered in the securities industry as a general securities representative in March 2000. He passed the uniform combined state law examination in April 2000.

X has been associated with the Sponsoring Firm since February 2003.⁴ He was previously employed by Firm One from April 2000 until March 2003.

X has no other regulatory or criminal history.

² X represents that he orally disclosed the misdemeanor charge and conviction to the Sponsoring Firm during his first job interview with the Firm in November 2002, and the record shows that he disclosed the incident on the Form U4 he filed with the Sponsoring Firm in February 2003.

³ The actual misdemeanor theft of property conviction against X is not a statutorily disqualifying event. *See* Art. III, Sec. 4(g)(1)(iii), NASD By-Laws (requiring that misdemeanor theft be of funds or securities). Thus, the discharge of the criminal conviction is irrelevant to X's status as a statutorily disqualified individual, which results from his March 2004 AWC for willful failure to disclose the misdemeanor charge and conviction to his then employer and NASD.

⁴ X served the nine-month suspension imposed by the AWC from April 2004 until January 2005. He returned to work at the Sponsoring Firm pending the consideration of this Application, which the Sponsoring Firm completed in January 2005. This is consistent with NASD's interpretation of Art. III, Sec. 3(c) of NASD's By-Laws, permitting individuals who become statutorily disqualified while they are employed to continue working pending the outcome of the statutory disqualification process.

B. The Firm

The Sponsoring Firm became an NASD member in May 1986. The Firm has no offices of supervisory jurisdiction and four branch offices. As of the second quarter of 2005, the Firm employed 732 registered representatives, 132 of whom are registered principals. The Firm is an introducing broker-dealer.

The Firm has the following disciplinary history. In January 1991, the State 2 Corporation Commission, Securities Division, fined the Firm \$3,500 because one of its representatives engaged in approximately 20 transactions with seven State 2 residents before State 2 had approved the Firm's license.

In October 2001, the Securities and Exchange Commission imposed an order Instituting Public Administrative Proceedings ("Order") against the Firm and its president, Employee 1. The Commission found that, from December 1991 to August 1993, the Firm and Employee 1 failed to reasonably supervise a former Sponsoring Firm registered representative. The Commission ordered that the Firm shall not maintain any branch office that is not supervised by an on-site registered principal and subjected to semi-annual surprise inspections, and shall not employ or contract with any registered representative who is not located in its main office or a branch office, unless that representative is subjected to an annual inspection, on a surprise basis if possible. The Commission also ordered the Firm and Employee 1 to each pay a civil penalty of \$50,000, and barred Employee 1 from association with any broker-dealer or investment adviser in a supervisory capacity with the proviso that, after one year, he may apply to become so associated.⁵

In 2003, NASD accepted a Letter of Acceptance, Waiver and Consent ("AWC") from the Firm that imposed a censure and a \$41,000 fine. The AWC cited the Firm for registration violations, continuing education violations, and failure to have appropriate written supervisory procedures regarding those areas.

The Firm currently employs one other statutorily disqualified individual, Employee 1, who is subject to a disqualification based on the Commission's Order, discussed above.

The record does not show any additional complaints, disciplinary proceedings, or arbitrations against the Firm.

⁵ In July 2002, the Commission issued a complaint and an application for a preliminary injunction against Employee 1 and the Sponsoring Firm, alleging that Employee 1 was violating the terms of his bar by acting as a supervisor. In September 2002, the United States District Court for State 3 granted the Commission's application for a preliminary injunction. In May 2003, the District Court granted the Commission's motion to dismiss the complaint, citing Employee 1's resignation as president and registered principal of the Sponsoring Firm, as well as evidence obtained through discovery.

IV. X's Proposed Business Activities and Supervision

The Firm proposes to continue to employ X as a general securities representative in its branch office in State 1. The Sponsoring Firm has further represented that X will be primarily involved in sales of mutual funds and variable products. The Firm will compensate X on a commission-only basis.

The Sponsoring Firm proposes that the Proposed Supervisor will be X's primary, responsible supervisor. The Proposed Supervisor is a branch manager at the branch office where X will be located, and he has been employed with the Sponsoring Firm since February 1997. The Proposed Supervisor has been employed in the securities industry since 1989, and he became registered as a general securities principal in September 1997.

The Proposed Supervisor has no disciplinary or regulatory proceedings, complaints, or arbitrations against him.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be approved, subject to the specified terms and conditions of heightened supervision over X set forth below.

VI. Discussion

After carefully reviewing the entire record in this matter, we approve the Firm's Application to employ X as a general securities representative, subject to the supervisory terms and conditions set forth below.

We acknowledge that X, as a registered representative, was responsible for knowing the rules of the securities industry and for providing information to Firm One on a timely basis to update his Form U4. *See, e.g., Robert E. Kauffman*, 51 S.E.C. 838, 840 (1993), *aff'd*, 40 F.3d 1240 (3d Cir. 1994) (table) ("Every person submitting registration documents [to NASD] has the obligation to ensure that the information printed therein is true and accurate."). We note, however, that although X did not bring the misdemeanor charge and conviction to Firm One's attention when he was employed there, he fully disclosed the misdemeanor charge and conviction to the Sponsoring Firm when he applied for a position there in November 2002 and when he completed his Form U4 in February 2003. X's disclosures to the Sponsoring Firm predated the start of Enforcement's investigation.

We also find that the Proposed Supervisor is well qualified and has no disciplinary history.

In addition, the Firm has been an NASD member since 1986 and it does not have an extensive regulatory history. We have considered that the past president of the firm, Employee 1, is also subject to a statutory disqualification for a failure to supervise violation. We note, however that X will not be located in the same office with Employee 1, that Employee 1 is now employed by the Firm only in a general securities representative capacity and will not be supervising X, and that

the Sponsoring Firm and the Proposed Supervisor have demonstrated their ability to supervise X in the State 1 branch office since February 2003. Finally, the Firm has agreed to the following comprehensive supervisory plan to ensure that it will be able to maintain future compliance with the plan of heightened supervision for X:⁶

1. The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;
2. X will not maintain discretionary accounts;
3. X will not act in a supervisory capacity;
4. The Proposed Supervisor will supervise X on-site when X is in the Sponsoring Firm's branch office located in State 1;
5. *At all times, while employed by the Sponsoring Firm, X will be required to keep in force an Errors & Omissions ("E&O") insurance policy;⁷
6. X will primarily be engaged in sales of mutual funds and variable products;
7. The Proposed Supervisor will review all of X's new account forms, on a weekly basis, and will evidence his review by signing the forms;
8. *The Proposed Supervisor will review and approve X's order tickets before they are executed, and will evidence his review by initialing the order tickets;
9. The Proposed Supervisor will randomly and periodically contact X's clients to ensure that X is maintaining good business practices. The Proposed Supervisor will maintain and segregate documentation related to those reviews, to allow for examiner access;
10. *The Proposed Supervisor will review X's outgoing and incoming written correspondence on a weekly basis;
11. X must disclose to the Proposed Supervisor, on a monthly basis, details related to his outside sales activity. The disclosure must contain X's activity log, phone call log, appointment log and a to-do list;

⁶ All of these procedures are heightened supervisory conditions for the Firm to impose, with the exception of those items denoted by an asterisk, which are standard operating procedures of the Firm that the supervisor of the particular office performs. For the purposes of the Firm's heightened supervisory procedures for X, however, the Proposed Supervisor will perform these responsibilities.

⁷ The Sponsoring Firm does not provide E&O insurance to its registered representatives. All the Sponsoring Firm associates are required to purchase policies from a reputable insurer.

12. All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the Firm's Compliance Department. The Proposed Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. The Proposed Supervisor will keep documents pertaining to these complaints segregated for ease of review;
13. For the duration of X's statutory disqualification, the Sponsoring Firm must obtain prior approval from Member Regulation if it wishes to change X's responsible supervisor from the Proposed Supervisor to another person; and
14. The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Sponsoring Firm's Compliance Department that the Proposed Supervisor and X are in compliance with all of the above conditions of heightened supervision.

NASD certifies that: 1) X meets all applicable requirements for the proposed employment; 2) the Firm is not a member of any other self-regulatory organization; 3) the Firm has represented that the Proposed Supervisor and X are not related by blood or marriage; and 4) in addition to X, the Firm currently employs one other statutorily disqualified individual, Employee 1.

Accordingly, we approve the Sponsoring Firm's Application to continue to employ X as a general securities representative. In conformity with the provisions of SEC Rule 19h-1, the continued association of X as a general securities representative with the Firm will become effective within 30 days of the receipt of this notice by the Commission, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary