

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Association of	Redacted Decision
X	<u>Notice Pursuant to</u>
as a	<u>Rule 19h-1</u>
General Securities Representative	<u>Securities Exchange Act</u>
with	<u>of 1934</u>
The Sponsoring Firm	<u>Decision No. SD06011</u>
	Date: 2006

**I. Introduction**

On November 17, 2005, the Sponsoring Firm<sup>1</sup> (or “the Firm”) submitted 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 associate with the Firm as a general securities representative. In April 2006, a subcommittee (“Hearing Panel”) of NASD’s Statutory Disqualification Committee held a hearing on the matter.<sup>2</sup> X appeared at the hearing, pro se, accompanied by his Proposed Supervisor and GC, the Firm’s president. LL and JK appeared on behalf of NASD’s Department of Member Regulation (“Member Regulation”).

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

**II. The Statutorily Disqualifying Event**

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<sup>1</sup> 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.

<sup>2</sup> Pursuant to NASD Procedural Rule 9524(a)(10), the Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. In turn, the Statutory Disqualification Committee considered the Hearing Panel’s recommendation and presented a written recommendation to the National Adjudicatory Council, in accordance with Procedural Rule 9524(b)(1).

X is statutorily disqualified because he pled guilty in November 1998, to driving while intoxicated (“DWT”), a felony in State 1. The court sentenced X to five years’ probation, revoked his driver’s license, and fined him \$1,000. The court granted X an early discharge of probation in July 2000, and reinstated his driver’s license in September 2000.

X’s 1998 DWI conviction was a felony because he had two prior DWI misdemeanor convictions in State 1 in September 1994 (resulting in a \$300 fine) and December 1994 (resulting in a \$500 fine and a six-month revocation of his driver’s license).

### **III. Background Information**

#### **A. X**

X first registered in the securities industry as a limited representative – investment company and variable contracts products (Series 6) in August 1988. He also passed the uniform securities agent state law examination (Series 63) in September 1988 and qualified as a general securities representative (Series 7) in October 2003.

X was previously associated with Firm One from June 1988 until December 2004, and Firm Two from January 2005 until February 2005. X filed a Uniform Application for Securities Industry Registration or Transfer (“Form U4”) with Firm Three in February 2005, but Firm Three declined to sponsor him as a statutorily disqualified person and X voluntarily resigned from Firm Three in March 2005. He has been employed with Firm Four as an independent contractor since March 2005, selling fixed annuities and non-variable life insurance products.

Firm Two discharged X in February 2005, stating on the Uniform Termination Notice for Securities Registration (“Form U5”) that he had failed to report a “disclosable item that occurred in 1998.”

In 2005, NASD’s Department of Enforcement (“Enforcement”) issued a Letter of Caution (“LOC”) against X for failing to disclose his 1998 felony charge and conviction on the Form U4 that he filed with Firm Two in January 2005.<sup>3</sup>

The record shows no other regulatory actions or complaints against X.

#### **B. The Firm**

The Sponsoring Firm became an NASD member in April 1969. The Firm is based in State 1 and has two branch offices and one office of supervisory jurisdiction (“OSJ”) that is also the Firm’s home office. The Sponsoring Firm’s MC-400 states that it employs 40 employees, of

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<sup>3</sup> Enforcement’s LOC did not address X’s failure to amend his Form U4 to disclose the felony charge and conviction to Firm One.

whom three are registered principals and 28 are registered representatives. The Firm is a full-service broker-dealer that clears through Firm Five.

NASD has begun, but has not yet completed, the 2005 routine examination of the Firm. NASD issued the Firm LOCs for the 2001 and 2003 routine examinations.

The 2001 LOC cited the Firm for violations of several rules, including inaccurately computing net capital, improperly reporting municipal securities transactions, incompletely reporting information on customer new account forms, failing to provide data for three customer complaints, and permitting a representative to conduct business without completing the required continuing education courses. The Firm responded in a letter dated November 2001, listing the actions it had taken with regard to deficiencies noted by NASD.

The 2003 LOC cited the Firm for inaccurately computing net capital, late filing of Forms U5, failing to produce an adequate plan for continuing education, failing to report one disclosable event, failing to report complete information on customer new account forms, and failing to properly report municipal securities transactions. The Firm responded in a letter dated November 2003, listing the measures it had taken with regard to the deficiencies cited by NASD.

The Firm also has an October 2002 Administrative Order against it by the State 2 Securities Division for maintaining customer accounts before the Firm's application to engage in securities business in State 2 was effective. The Firm paid a \$10,000 fine to the State 2 securities authority in October 2002.

The record shows no other customer complaints, regulatory proceedings, or arbitrations against the Firm.

#### **IV. X's Proposed Business Activities and Supervision**

The Firm proposes to employ X as a general securities representative in its branch office in State 1. The Sponsoring Firm will compensate X on a commission basis.

The Sponsoring Firm proposes that the Proposed Supervisor will be X's primary, responsible supervisor. The Proposed Supervisor has been employed by the Sponsoring Firm since May 1993, and is the branch manager at the State 1 branch office where X will be employed. The Proposed Supervisor currently supervises two other registered representatives at that location. He has been employed in the securities industry since 1983, becoming registered as a uniform securities agent (Series 63) in April 1984, a general securities representative in April 1984, a general securities principal in May 2003, and a registered options principal in December 2003.

The Proposed Supervisor was previously associated with Firm A from February 1984 until April 1993. Firm A terminated the Proposed Supervisor in April 1993, stating on the Form U5 that "N/A two allegations of unauthorized transactions. There were no customer complaints and no claims of damages." Firm A subsequently filed an amended Form U5 in October 1993,

stating that the Proposed Supervisor was the subject of four customer complaints that alleged unauthorized purchases in their accounts. NASD's Central Registration Depository ("CRD<sup>®</sup>") does not contain any information regarding monetary damages or settlements of these complaints. The Proposed Supervisor testified at the hearing that he was unaware of the customer complaints until Firm A filed the amended Form U5 with NASD in October 1993, six months after he had departed Firm A.<sup>4</sup> The Proposed Supervisor also stated that Firm A removed the trades from the customers' accounts, never asked him about the trades in question, and that he "presume[s] there was no monetary consequence."

The record does not contain any other disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

## **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.

In reviewing this type of application, we consider 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>5</sup> We assess the totality of the circumstances in reaching a judgment about X's future ability to deal with the public in a manner that comports with NASD's requirements for high standards of commercial honor and just and equitable principles of trade in the conduct of his business.

For the reasons set forth below, we conclude that X's participation in the securities industry will not present an unreasonable risk of harm to the market or investors.

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<sup>4</sup> The Proposed Supervisor earlier provided this information on a Disclosure Occurrence Composite filed with NASD in July 1999.

<sup>5</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).

We acknowledge the seriousness of X's criminal conviction. We note, however, that his felony DWI conviction occurred in 1998, more than eight years ago, and we are not aware of any intervening criminal misconduct. We also recognize that X has been punished for his felony offense by a State 1 court, which fined him \$1,000, revoked his driver's license, and placed him on probation for five years. X paid his fine, his probation was terminated in July 2000, and his driver's license was reinstated in September 2000. X also completed the required substance abuse evaluation by July 2000.<sup>6</sup> Moreover, X has been employed in the securities industry since 1988 and has no disciplinary history.

We also acknowledge that X, as a registered representative, was responsible for knowing the rules of the securities industry and for providing information about his 1998 felony charge and conviction to Firms One and Two on a timely basis. *See e.g. Robert E. Kauffman*, 51 S.E.C. 838, 840 (1993) ("Every person submitting registration documents [to NASD] has the obligation to ensure that the information printed therein is true and accurate."), *aff'd*, 40 F.3d 1240 (3d Cir. 1994) (table). As to Firm One, we note, however, that X maintains that he provided timely oral notice to Firm One of the 1998 criminal matter and that X's contention is corroborated in the record by a letter dated February 2006, from his former supervisor at Firm One. X testified at the hearing that he did not attempt to conceal his 1998 felony conviction from Firm One, that he gave the information about the conviction to his former supervisor, and that his colleagues were all aware of his conviction particularly because co-workers had to drive him to appointments during the time that his driver's license was suspended. Thus, the record shows that X provided full disclosure orally to Firm One at the time of the felony event and did not attempt to conceal his criminal record.

As to Firm Two, we note that X's failure to amend his Form U4 to disclose the felony charge and conviction to Firm Two has previously been addressed by NASD's Department of Enforcement. In its investigation of the matter with X, Enforcement had a choice as to whether it would proceed against him for a willful violation, or a non-willful violation. The distinction between a willful and non-willful failure to disclose is critical because a willful failure results in a separate, lifetime statutory disqualification under the Securities Exchange Act of 1934 ("the Exchange Act") and the NASD By-Laws.<sup>7</sup> Enforcement evaluated all of the circumstances

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<sup>6</sup> X testified that he had attended counseling sessions and meetings of Alcoholics Anonymous as required by the court. He stated that the outcome of those sessions showed that he did not have a dependency on alcohol, and that he had since made major changes in his lifestyle to ensure that he did not develop a dependence on alcohol. X testified that he occasionally drinks alcohol with dinner, but has had no "relapses" since he attended counseling.

<sup>7</sup> Art. III, Sec. 4(f) of NASD's By-Laws provides that a person is subject to a statutory disqualification if that person:

has willfully made or caused to be made in any application . . .  
to become associated with a member of a self-regulatory organization, . . .  
any statement which was at the time, and in light of the circumstances

[Footnote continued on next page]

regarding X's failure to disclose and determined that his violation was non-willful, thereby resulting in the 2005 LOC rather than a formal disciplinary action. In reaching its determination, Enforcement considered a May 2005 letter from X's former counsel, stating that X was not aware that his conviction was a felony when it occurred in 1998, and that he relied upon the advice of his counsel in determining that he was not required to disclose it on his Form U4.<sup>8</sup>

The Proposed Supervisor is well qualified and has worked in the securities industry since 1984 with no formal disciplinary history. The four customer complaints against him and his termination from Firm A appear to be related to one distinct period, April 1993, in his 22-year career in the securities industry. Moreover, the record does not show that there were any monetary awards or compensatory damages from these complaints. We find that these complaints will not have a negative impact on the Proposed Supervisor's ability to supervise X.

The Sponsoring Firm is a long-standing member of NASD, with no formal disciplinary history. The Firm has agreed to a comprehensive supervisory plan to ensure that it will be able to maintain heightened supervision for X.

In sum, given the nature of X's felony offense, his lack of willful intent to conceal it from his employers, and the fact that he previously has been successfully employed in the securities industry, we conclude that the following supervisory conditions agreed to by the Sponsoring Firm will provide the enhanced compliance measures necessary to monitor X's activities:<sup>9</sup>

1. \*The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;

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under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application . . . any material fact which is required to be stated therein.

<sup>8</sup> X's former counsel stated that he, the sentencing judge, and X had believed that X did not have to disclose the 1998 felony charge and conviction because the State 1 court issued him a Certificate of Relief from Disabilities in January 1999. The Securities and Exchange Commission has stated that such a certificate, while restoring certain rights and responsibilities of citizenship, does not remove a person from statutory disqualification. Instead, the Commission has held that a certificate is a "factor to be considered" in a statutory disqualification proceeding. *Jonathan Scott Saluk*, Order on Petition for Rehearing, Exchange Act Rel. 35623, 1995 SEC LEXIS 923 (Apr. 19, 1995). X acknowledged at the hearing that he now realizes that a certificate does not excuse his statutory disqualification and he is aware that he must fully disclose the felony charge and conviction on Forms U4.

<sup>9</sup> The items denoted by an asterisk are heightened supervisory conditions and not standard operating procedures of the Firm.

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 Firm's State 1 branch office;
5. The Firm will permit X to conduct sales calls outside of the office;
6. \*X must disclose all customer meetings when they are scheduled, or as soon as practicable (shortly after any unscheduled meeting). Based on X's monthly transaction activities, the Proposed Supervisor will randomly contact at least 10% of those customers, on a monthly basis, to ensure that X has conducted himself in an appropriate manner and has complied with the Sponsoring Firm's rules and regulations. The Proposed Supervisor will memorialize his findings in the form of a Memo to File, which he will print and keep segregated for ease of review during any statutory disqualification audit;
7. The Proposed Supervisor will review and pre-approve each securities account, prior to the opening of the account by X. The Proposed Supervisor will document his review with a date and signature and maintain the paperwork at the Sponsoring Firm's home office for audit purposes;
8. \*The Proposed Supervisor will personally meet with X on a quarterly basis to review all aspects of his business;
9. X will not, under any circumstances, be permitted to accept cash. All client checks must be made payable to Firm Five, an insurance company, or a mutual fund and be forwarded to the Sponsoring Firm on the day X receives them;
10. \*The Proposed Supervisor will review X's incoming written correspondence (which will include e-mail communications) upon its arrival and will review X's outgoing correspondence before it is sent;
11. \*For the purposes of client communication, X will only be allowed to maintain an e-mail account that is held at the Firm, with all e-mails being filtered through the Sponsoring Firm's e-mail system. The Proposed Supervisor will conduct a weekly review of all e-mail messages that X sends or receives. The Proposed Supervisor will print the e-mail messages and keep them segregated for ease of review during any statutory disqualification audit;
12. \*The Proposed Supervisor will review and approve X's orders before they are executed, or as soon as practicable, on a "T+1" basis. The Proposed Supervisor

will then review the trade reports on a T+1 basis, evidence his review by initialing the reports, and keep copies of the reports segregated for ease of review;

13. All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the Compliance Department of the Sponsoring Firm. 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 all documents pertaining to these complaints segregated for ease of review;
14. If the Proposed Supervisor is to be on vacation or out of the office, the Proposed Supervisor 2 will act as X's interim supervisor;
15. \*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
16. \*The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Compliance Department of the Sponsoring Firm that he 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 X and the Proposed Supervisor are not related by blood or marriage; and 4) the Firm currently employs no other statutorily disqualified individuals.

## **VII. Conclusion**

Accordingly, we approve the Sponsoring Firm's Application to employ X as a general securities representative. In conformity with the provisions of SEC Rule 19h-1, the 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,

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Barbara Z. Sweeney  
Senior Vice President and Corporate Secretary