

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

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

PATRICK H. SMITH
(CRD No. 1821303),

Gastonia, NC,

Respondent.

Disciplinary Proceeding
No. C07010095

Hearing Officer—Andrew H. Perkins

Hearing Panel Decision

May 6, 2002

The Respondent violated NASD Conduct Rule 2110 and SEC Regulations T and X. The following remedial sanctions were imposed: (1) the Respondent was suspended for two years as a Financial and Operations Principal and a General Securities Principal; (2) the Respondent was suspended for three months from associating with any member firm in any capacity; (3) the Respondent was ordered to requalify by examination in his principal capacities; (4) the Respondent was required to have all his transactions for his personal accounts pre-approved by his firm for one year; and (5) the Respondent was fined \$30,000 and ordered to pay the costs of this proceeding.

Appearances

Gene E. Carasick, Regional Counsel, Atlanta, GA, and Rory C. Flynn, Chief Litigation Counsel, Washington, DC, Of Counsel, for the Department of Enforcement.

Patrick H. Smith appeared on his own behalf.

DECISION

The Complaint charges Respondent Patrick H. Smith (“Smith” or the “Respondent”) with violating NASD Conduct Rule 2110, Regulation T (12 C.F.R. § 220 et seq.), and Regulation X (12 C.F.R. § 224 et seq.).¹ The Complaint alleges that Smith, while registered as a General Securities Principal and Financial and Operations Principal at Jackson & Smith Investment Securities, LLC (“Jackson & Smith” or the “Firm”), made 242 purchases of securities in his personal account at the Firm for which he did not make timely payment as required by Regulation X. The Complaint further alleges that by failing to pay for the purchases in a timely manner he permitted the Firm to extend him credit in violation of Regulation T.

I. PROCEDURAL HISTORY

The Department of Enforcement (“Department”) filed the Complaint against Smith on December 17, 2001. Smith answered the Complaint by admitting all of the factual allegations and requesting a hearing on sanctions.

In accordance with Smith’s request, a hearing on sanctions was held on March 1, 2002, in Charlotte, North Carolina, before a Hearing Panel comprised of the Hearing Officer and two current members of the District 7 Committee. The Department called the Respondent as a witness.² Smith called his father, the only other General Securities Principal at Jackson & Smith, to testify in his defense. The only documentary evidence offered was the Parties’ joint stipulations dated February 5, 2002, Exhibit J-1, which the

¹ Regulations T and X are promulgated under Section 7(f) of the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. § 78(g)(f).

² The hearing transcript is referenced as: “Tr. at ____.”

Department filed with its pre-hearing submissions.³ Smith stipulated to the material underlying facts and to violating NASD Conduct Rule 2110 and Regulations T and X.

II. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. The Respondent

Smith has been in the securities industry for approximately 14 years. He started in March 1988 when he joined Jackson & Smith, a broker-dealer his grandfather founded in 1931.⁴ Through his association with Jackson & Smith, he registered with the National Association of Securities Dealers, Inc. (“NASD”) as a General Securities Representative, a General Securities Principal, an Equity Trader, and a Financial and Operations Principal. Smith currently is associated with Jackson & Smith and remains registered in all four capacities.⁵ Smith had no disciplinary history before the filing of the present proceeding.

B. Jurisdiction

NASD Regulation, Inc. has jurisdiction over this proceeding. Smith was registered with the NASD both when he is alleged to have committed the violations charged in the Complaint and when the Department filed the Complaint.

C. Summary of Smith’s Violations

In January 1999, Smith started day trading in his personal account at Smith & Jackson in order to make some extra money.⁶ Smith testified that his wife, who was expecting their second child, had quit work. The resulting loss of income created a burden

³ The Stipulations are referenced as: “Stip. ¶ ____.”

⁴ Stip. ¶ 1; Tr. at 30.

⁵ Stip. ¶ 1.

⁶ Tr. at 12.

for him, and he thought that he could make up some of the short fall by making short-term transactions.⁷

Between January 7, 1999, and November 15, 2000, Smith effected 242 purchases of securities in his personal securities account for a total purchase price of \$11,593,471.98.⁸ In effect, he ran his personal account as if it were a proprietary trading account.⁹ Smith did not, however, pay for the purchases as required by Regulation T. Instead, in most instances he netted out his short-term positions against other trades in his account. He was able to do this because at the time the Firm was self-clearing, and it cleared its trades on a delivery versus payment basis. Thus, his strategy was to sell each position before payment was due.¹⁰ He admits, however, that in some cases he held securities past the mandatory settlement date.¹¹

Smith's day-trading strategy was not successful. By late 2000, he found himself in substantial debt, without the means to settle his account. Finally, Herzog, Heine, Geduld, Inc. demanded payment for the securities Smith purchased through that firm, which forced Smith to tell his father about his trading losses.¹² By that time, the cumulative losses had amounted to about \$500,000.¹³ Smith's father agreed to help his son clear up the account.

⁷ Id. at 14.

⁸ Stip. ¶ 3.

⁹ Tr. at 21.

¹⁰ Id.

¹¹ Id. at 20.

¹² Id. at 15.

¹³ Id. at 14.

Ultimately, Smith's father contributed approximately \$350,000 from his savings toward his son's debt.¹⁴ Smith came up with the balance by selling other securities he owned.¹⁵

Smith violated Regulations X and T by not paying for the securities he purchased. Regulation T (12 C.F.R. § 220.8(d)) requires that payment for a securities purchase be obtained from a customer within one payment period—which in 1999-2000 was five business days. Smith admits that he did not have the money to pay for the 242 purchases he effected in his personal account, as charged in the Complaint; his intent was to net the purchases out before payment was demanded by the selling firm. Such day trading violates Regulation T.¹⁶ Regulation X, on the other hand, is violated by a borrower who causes an extension of credit in violation of Regulation T. Here, the evidence establishes that Smith, the Firm's FINOP, arranged for the extensions of credit, in violation of Regulation T.

Accordingly, based on Smith's admissions, the Hearing Panel finds that he violated NASD Conduct Rule 2110 and SEC Regulations X and T, as alleged in the Complaint.

III. SANCTIONS

The NASD Sanction Guidelines for violations of Regulation T recommend a fine of \$1,000 to \$50,000 and a suspension of up to two years or a bar in egregious cases.¹⁷ There is not a separate guideline for violations of Regulation X.

The Department urged the Hearing Panel to find that Smith's violations were egregious and, as a result, to impose serious sanctions. Specifically, the Department

¹⁴ Id. at 28.

¹⁵ Id. at 15.

¹⁶ Cf. District Bus. Conduct Committee v. Prime Investors, Inc., No. C04930065, 1995 NASD Discip. LEXIS 219 (NBCC Sept. 11, 1995) (holding that day trades in cash account which were paid for with the proceeds of the sale of the same securities established a clear pattern of nonpayment for securities, in violation of Regulation T).

proposed the following sanctions: (1) a one-year suspension in all capacities; (2) a two-year suspension in his capacity as a FINOP; (3) requalification by examination as a FINOP; (4) a requirement that, for a period of one year following Smith's re-entry into the securities industry, all of his transactions be reviewed and that he have the required funds in his account prior to execution of any purchases; and (5) a \$40,000 fine (\$20,000 each for the Regulation T and Regulation X violations).¹⁸ The Department considered Smith's conduct to be egregious because he engaged in a pattern of misconduct over a substantial period for personal gain.

Smith, on the other hand, urged the Hearing Panel to consider several mitigating factors. Smith pointed out that he implemented corrective measures before the NASD intervened and cooperated with the ensuing investigation. He also expressed deep remorse for his mistakes. Both Smith and his father argued that Smith has learned from his mistakes and, if given a second chance, he will be far more diligent in the future with respect to compliance issues. They also stressed that no customers were involved. With these factors in mind, Smith proposed the following sanctions: (1) a \$15,000 fine; (2) a six-month suspension from association with any NASD member in the capacity of a FINOP; (3) requalification as a FINOP by taking and passing the Series 27 qualification examination before again functioning as a FINOP with an NASD member; (4) review for two years of all of his trading activity in all accounts in which he has a beneficial interest;

¹⁷ NASD Sanction Guidelines 35.

¹⁸ The Department expressed its opinion that under the circumstances a bar could be justified, but not warranted. (Tr. at 35.)

and (5) a restriction that, for five years, all of his accounts shall be maintained only on a fully-disclosed basis.¹⁹

The Hearing Panel carefully considered both proposals in light of the NASD Sanction Guidelines and concluded that Smith's misconduct was serious. The Hearing Panel rejects Smith's casual characterization that he simply was caught up in the frenzy of day trading, causing him to lose sight of his obligations. Smith was the Firm's FINOP. As such, he was responsible for the Firm's compliance with Regulation T. Smith cannot minimize his misconduct by pointing to such factors as the volatility of the market.²⁰ While Smith may have lacked an intent to harm others, he placed the Firm at substantial risk. Smith acknowledged that he knew the trading strategy he used was very risky.²¹ Nevertheless, he ignored his responsibilities as a registered principal and continued trading even after he had lost a significant amount.²² Indeed, Smith admitted that he knew what he was doing was wrong once he began to lose money.²³ Moreover, the Hearing Panel cannot ignore the fact that Smith engaged in a sustained pattern of misconduct involving the purchase of securities with a market value of nearly \$11.6 million.

For the foregoing reasons, the Hearing Panel concludes that Smith should be suspended in all principal capacities for two years and ordered to requalify by examination before he is allowed to resume those functions. On the other hand, the Hearing Panel

¹⁹ Smith submitted the Offer of Settlement ("Offer") on January 14, 2002. At the Initial Pre-Hearing Conference he withdrew the Offer from consideration as a contested offer of settlement in order to avoid the need for a separate hearing on the Offer.

²⁰ See Tr. at 37.

²¹ Tr. at 13.

²² Id. at 14-15.

²³ Id. at 39.

determines that a lesser suspension of his registration as a General Securities Representative will adequately meet the remedial purpose of sanctions in this case. Smith's errors in judgment did not affect his relations with customers. Accordingly, the Hearing Panel will suspend Smith from associating with any member firm in any capacity for three months.

The Hearing Panel agrees with the Parties' proposals that Smith's trading activities should be reviewed and approved once he re-enters the securities industry. Accordingly, the Hearing Panel will order that for one year (1) his firm shall approve all of his transactions in any account in which he has a beneficial interest before they are executed, and (2) Smith shall have sufficient funds in his account to cover any of those transactions. Finally, the Hearing Panel concludes that Smith should be fined a total of \$30,000 for his violations of Regulation T and X.

IV. ORDER

Having considered all of the evidence,²⁴ the Hearing Panel orders as follows:

1) Patrick H. Smith is suspended from association with any NASD member firm in his capacity as a General Securities Principal and a Financial and Operations Principal for two years.

2) Patrick H. Smith is suspended for three months from associating with any member firm in any capacity.

3) Patrick H. Smith is ordered to requalify by examination as a General Securities Principal and a Financial and Operations Principal before he resumes those responsibilities.

²⁴ The Hearing Panel considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.

4) For one year following Patrick H. Smith's association with a member firm, his firm shall review and pre-approve all transactions for his personal accounts (including all accounts in which he has a beneficial interest) and require that he have sufficient funds in his accounts to settle all transactions before they are executed.

5) Patrick H. Smith is fined \$30,000.

6) Patrick H. Smith is ordered to pay costs in the total amount of \$1,378.88, which includes an administrative fee of \$750 and hearing transcript costs of \$628.88.

These sanctions shall become effective on a date set by the NASD, but not earlier than 30 days after this Decision becomes the final disciplinary action of the NASD, except, if this Decision becomes the final disciplinary action of the NASD, the suspensions shall become effective as follows: (1) the two-year suspension of his registrations as a General Securities Principal and a Financial and Operations Principal shall commence with the opening of business on Monday, July 1, 2002, and end at the close of business on June 30, 2004; and (2) his suspension in all other capacities shall commence with the opening of business on Monday, July 1, 2002, and end at the close of business on September 30, 2002.

Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

Patrick H. Smith (by FedEx, next day delivery, and first-class mail)
Gene E. Carasick, Esq. (by first-class and electronic mail)
Rory C. Flynn, Esq. (by first-class and electronic mail)