

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of
the Continued Association of

X

as a

General Securities Principal

with

The Sponsoring Firm

Redacted Decision

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

SD Decision No. 02003

On July 31, 2001, the Sponsoring Firm (or "the Firm") completed a Membership Continuance Application ("MC-400" or "the Application") requesting permission for X¹, a person subject to a statutory disqualification but currently associated with the Firm as an equity trader, to continue to associate with the Firm as a general securities principal.² A hearing was not held in this matter. Rather, pursuant to NASD Procedural Rule 9523, the Department of Member Regulation ("Member Regulation") of NASD Regulation, Inc. ("NASD Regulation") recommended to the Statutory Disqualification Committee that X's proposed continued association with the Firm as a general securities principal be approved pursuant to the terms and conditions set forth below.

X's Statutorily Disqualifying Event. X is subject to a statutory disqualification as the result of his 1992 guilty plea in the Supreme Court for State 1 to charges of criminal sale of a controlled substance (one-half ounce of cocaine). The conviction was a second-degree felony. X was sentenced to lifetime probation; however, in 1997, he was granted an early discharge from probation. He also was issued a Certificate of Relief from Civil Disabilities in 1996. We note that X's statutory disqualification expires on March 27, 2002.

X's Background. X previously has been approved on three occasions by NASD to associate with a member firm as a statutorily disqualified person. Pursuant to an SEC Rule 19h-1 notice dated June 2, 1997 ("the June 2, 1997 Notice"), NASD approved X's association with a

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.

² X has been associated with the Sponsoring Firm as an equity trader since December 4, 2000. The history of X's prior 19h-1 filings is discussed in more detail below.

different member firm as an apprentice trader only. The Securities and Exchange Commission ("SEC" or "the Commission") confirmed that approval on July 7, 1997.

X was registered with that firm only from July through September 15, 1997. Thereafter, X became associated with the Sponsoring Firm as an apprentice trader from September 15, 1997 until January 13, 1998, despite the fact that the Sponsoring Firm had not sought prior approval to employ a statutorily disqualified individual, as required by NASD and New York Stock Exchange ("NYSE") rules. As a result of this transgression, disciplinary proceedings were initiated against both the Sponsoring Firm and X by NASD Regulation. The Sponsoring Firm entered into a Letter of Acceptance, Waiver and Consent ("AWC") that was accepted by NASD Regulation's National Adjudicatory Council ("NAC") in 1999 ("the 1999 AWC"). The Sponsoring Firm consented to findings of violations of Article III, Section 3 of NASD's By-Laws and Conduct Rule 2110 and to sanctions of a censure and fine of \$50,000. A Letter of Caution ("LOC") was issued to X in 1999.

From January 1998 through August 23, 1999, X was not associated with the Sponsoring Firm. Rather, he awaited the completion of NASD Regulation's disciplinary proceedings. On August 23, 1999, Member Regulation approved X's association with the Sponsoring Firm as an apprentice trader, pursuant to SEC Rule 19h-1(a)(3)(ii). Subsequently, NASD filed a Rule 19h-1 notice with the Commission on October 31, 2000 ("the October 31, 2000 Notice"), approving X's continued association with the Sponsoring Firm in the capacity of an equity trader. This notice also provided that the Sponsoring Firm was not required to file another MC-400 application if it determined to expand X's duties commensurate with registration as a general securities representative. The Commission acknowledged this approval in a letter dated December 4, 2000.

X took and passed the Series 24 (general securities principal) qualification examination on April 19, 2001. We are not aware of any other regulatory actions taken against X in any capacity.

The Firm. The Sponsoring Firm has been a member of NASD since 1936 and has been in the securities business for 125 years. The Sponsoring Firm has four offices of supervisory jurisdiction and six branch offices. It is a full-service investment bank engaged in the retail brokerage business. The Firm employs 40 registered principals and 251 registered representatives.

The following is a summary of the Firm's disciplinary history for the past 10 years, excluding the Firm's 1997 AWC for employing X, as described above.

In 2000, NASD Regulation accepted an AWC finding violations of NASD and SEC firm quote rules, as well as inadequate written supervisory procedures to govern compliance with those rules. The Firm consented to a censure and a fine in the amount of \$8,000.

In 1999, NASD Regulation accepted an AWC, finding that the Sponsoring Firm had violated NASD Systems and Programs, Rule 6130(d), an Automated Confirmation Transaction Service ("ACT") rule. The Sponsoring Firm failed promptly to update its quotations on limit

orders, and inaccurately reported short sales to ACT without including the ".S" modifier. The Firm consented to a \$2,000 fine.

In 1997, the Sponsoring Firm consented to a \$125,000 fine and a censure by the Chicago Board of Options Exchange ("CBOE") for violations of CBOE Rules in connection with the supervision of a former employee who had perpetrated a fraud against the Sponsoring Firm.³ In addition to the fine and censure, the Sponsoring Firm agreed, among other things, to establish a procedure whereby supervisors would be made aware of active account reports for employees' personal accounts under certain circumstances.

NASD accepted an AWC in 1994, which resulted in a censure and \$7,500 fine. The Sponsoring Firm was found to have acted in contravention of the Board of Governors' free-riding and withholding interpretation, now IM-2110-1.

The Sponsoring Firm settled administrative proceedings with the SEC in 1993 resulting in a cease and desist order. The Sponsoring Firm was found to have purchased from and sold to the public approximately 66,000 shares of common stock worth about \$40,000 without having a registration statement filed or in effect, and without an exemption.

NASD accepted an AWC in 1993, finding that the Sponsoring Firm had updated quotations in the OTC Bulletin Board system outside of the allowable time. The Firm consented to a \$250 fine.

Moreover, within the past 10 years, the Sponsoring Firm has entered into settlement agreements with the following states as a result of registration violations: State 2, State 3, State 4, State 5, State 6, and State 7.

Finally, the Sponsoring Firm states in its MC-400 Application that it is a defendant in several class action lawsuits concerning public offerings of securities for which it was a member of the syndicate, but not the lead underwriter.

We are not aware of any other complaints, disciplinary proceedings, or arbitrations against the Firm. The Sponsoring Firm does not employ any other statutorily disqualified individuals.

³ The Sponsoring Firm failed reasonably to supervise a former associated person who worked as a trader's assistant on the Sponsoring Firm's proprietary trading desk. The trader's assistant caused numerous losing option trades that he originally effected for his personal trading account and/or the accounts of other Sponsoring Firm employees to be assigned to the Sponsoring Firm's proprietary accounts, and converted the Sponsoring Firm's funds to his own use by causing certain profitable option trades that he originally effected for the Sponsoring Firm's proprietary accounts to be assigned to his personal trading account.

X's Proposed Business Activities. The Sponsoring Firm proposes that X continue to be employed in the Firm's main office in State 1. He would act as an assistant head trader on the Firm's OTC desk. The Firm proposes that he will have the following responsibilities:

- Recruiting Nasdaq traders and support personnel;
- Acting as liaison with the CEO and COO – implementing expansion;
- Acting as liaison between the compliance director and the trading desk – implementing procedures to comply with new regulatory requirements as needed;
- Acting as liaison with the IT director – implementing new systems/technology;
- Working with broker-dealer services – meeting with other broker-dealers in an effort to generate more business; and
- Acting as liaison between the Firm and other broker-dealers regarding disputes, e.g. trading issues. Coordinating resolution between the Firm's traders and opposing traders from other firms.

The Sponsoring Firm will compensate X with a base salary, override, and bonus.

The Proposed Supervisor. The Sponsoring Firm proposes that the Proposed Supervisor would be responsible for supervising X. The Proposed Supervisor is the head trader for the Sponsoring Firm's OTC desk. He has been registered as a general securities representative since 1993, and has been a general securities principal since January 1998. The Proposed Supervisor took and passed the Series 55 (equity trader) examination in April 2000.

We are not aware of any disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor

Member Regulation's Recommendation. Member Regulation recommends that X's association with the Sponsoring Firm as a general securities principal be approved.

Discussion. After careful review of the entire record in this matter, we have determined to approve the Sponsoring Firm's Application to continue to employ X as a general securities principal, effective upon the Commission's grant of approval. We are mindful of the fact that X committed a serious offense, but we find that he has rehabilitated himself over the past nine years since his conviction involving the sale of a controlled substance. X was 23 years old and had been out of college for one year at the time of his offense. He has since been discharged from his lifetime probationary term, and he has been registered as an apprentice trader with the Sponsoring Firm since August 1999, and as an equity trader since December 2000 and has not engaged in any intervening misconduct. Strict supervision will be provided by the Proposed Supervisor, who has supervised X in other capacities since May 2001. The Proposed Supervisor has nine years of industry experience and no disciplinary history.

With respect to the prior disciplinary incident involving X's association with the Sponsoring Firm prior to NASD's approval, we believe that the following mitigating factors deserve consideration: First, the Sponsoring Firm apparently was confused, based on

conversations that it and outside counsel had with an NASD Regulation Compliance and Disqualification Specialist, about whether X could associate in a clerical capacity prior to obtaining approval. Second, the Sponsoring Firm subsequently instituted a policy providing that if the Sponsoring Firm hires a statutorily disqualified person, that person will be prohibited from being on the Sponsoring Firm's premises until the necessary approvals are obtained from the appropriate regulatory agencies. Third, the Sponsoring Firm and X have already been sanctioned for this mistake in an NASD disciplinary proceeding and an LOC.

As to the Sponsoring Firm's disciplinary history, we first note that the number of disciplinary incidents involving the Sponsoring Firm is not out of the ordinary for a large firm. We also have considered that only two of the Firm's disciplinary incidents occurred in the past four years. Further, we note that none of the Sponsoring Firm's past disciplinary events appears to bear directly on the Sponsoring Firm's ability to supervise X effectively. As noted by Member Regulation, the Firm's most recent AWC (involving violations of firm quote rules) does not involve a claim that the Sponsoring Firm failed to supervise its employees, although it does involve deficiencies in the supervisory procedures governing compliance with the SEC's firm quote rules. The Firm has revised its written supervisory procedures to correct the deficiencies noted. Additionally, with respect to the Firm's 1997 settlement with the CBOE, we note that the incident involved a former employee who took steps to conceal his unlawful activity from the Firm, and that the Firm, in response to the CBOE's investigation, implemented adequate procedures.

Accordingly, based on the totality of the circumstances, we find that it would not be an unreasonable risk to the market or investors for X to act in the capacity of a general securities principal, with the following supervisory procedures and operating restrictions, to which the Firm has agreed:

1. X will sit in close physical proximity to the Proposed Supervisor, on the same OTC desk, in the same location.
2. X will act as a principal on the Firm's OTC desk, carrying out the specified duties as expressed in above in the section entitled "X's Proposed Business Activities."
3. X will have no dealings with public customers of the Sponsoring Firm, nor shall he be authorized to commit any of the Sponsoring Firm's capital.
4. X will not be responsible for servicing accounts or providing investment advice to the Sponsoring Firm's customers.
5. All of X's outgoing correspondence will be approved by the Proposed Supervisor prior to being sent. The Proposed Supervisor will review all incoming correspondence. The Proposed Supervisor will maintain copies of all outgoing and incoming correspondence with his initials, thereby evidencing his review and approval.

6. The Proposed Supervisor will meet with X on a quarterly basis to review his transactions. A log shall be kept by the Firm of these meetings.
7. All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the director of compliance. The Proposed Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint and the resolution of the matter. Documents pertaining to these complaints will be kept segregated for ease of review.
8. 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.

NASD certifies that: (1) X meets all applicable requirements for the proposed employment; (2) the Firm employs no other individuals who are subject to a statutory disqualification; and (3) X and the Proposed Supervisor have represented that no familial relationship exists between them. In addition to being an NASD member, the Sponsoring Firm is a member of the American Stock Exchange, the CBOE, the New York Stock Exchange, and the Pacific Stock Exchange. Each of these self-regulatory organizations has been advised that NASD Regulation intends to provide this notice to the SEC.

Accordingly, the Sponsoring Firm's Application for X to continue to be associated with the Firm as a general securities principal will become effective within 30 days of the Commission's receipt of this decision, unless otherwise notified by the Securities and Exchange Commission.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary