

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

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| In the Matter of the Association | Redacted Decision |
| of | <u>Notice Pursuant to</u> |
| X | <u>Section 19h-1</u> |
| as a | <u>Securities Exchange Act</u> |
| General Securities Representative | <u>of 1934</u> |
| with | <u>SD00001</u> |
| The Sponsoring Firm | |

On July 22, 1999, a member firm ("the Sponsoring Firm") submitted an MC-400 Membership Continuance Application ("Application") to permit a person subject to a statutory disqualification ("X")¹, to associate with the Sponsoring Firm as a general securities representative. In December 1999, a subcommittee 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 Proposed Supervisor"), and the Firm's Director of Compliance.

X. X is subject to a statutory disqualification as a result of his 1997 conviction on two counts of felony arson, in violation of a State Statute. He was 18 years old and in a college fraternity at the time of his violations. X pleaded guilty of knowingly, by means of fire, damaging two automobiles in 1997, without the consent of the owner, and he was sentenced to 24 months' probation, fined \$1,000, and ordered to pay restitution in the amount of \$300. X's two-year probationary term began in December 1997 and ended in November 1999.

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.

X provided a statement to the Department of Member Regulation ("Member Regulation") staff explaining that he had been involved in a fraternity prank that accidentally led to the vehicles' being damaged. According to the statement, X and a few friends attempted to burn the Greek letters of their fraternity onto the neighboring fraternity's lawn, apparently in retaliation for a prank perpetrated on X's fraternity by the neighbor. The fire spread beyond the intended area and damaged two cars. X's statement expresses contrition, remorse, and guilt for these actions.

X was a stockbroker trainee at Firm A from June through September 1997. On November 23, 1997, when X filled out his Uniform Application for Securities Industry Registration or Transfer ("Form U-4") to associate with Firm B, he neglected to indicate that he had been charged with and convicted of the two counts of arson. He then became associated with Firm B, passed the Series 7 on March 4, 1998, and became a registered representative with Firm B on March 5, 1998. Firm B terminated X in May 1998, after he was found to be statutorily disqualified.

In 1999, X submitted a Letter of Acceptance, Waiver and Consent ("AWC") to NASD Regulation, in which he admitted to having failed to disclose the convictions on his Form U-4, in violation of Conduct Rule 2110. There was no finding that this omission was either willful or material. X consented to a censure, a three-month suspension from association with any NASD member, and a fine of \$5,000. The AWC was accepted by the National Adjudicatory Council, and NASD Regulation confirmed receipt of the \$5,000 from X. X's three-month suspension has been served.

The Sponsoring Firm. The Sponsoring Firm became a member of the Association in 1993. It is engaged in the businesses of institutional and retail sales as well as proprietary trading. The Sponsoring Firm is a self-clearing firm, and it has two offices of supervisory jurisdiction ("OSJs") and no branch offices. The Sponsoring Firm employs 46 general securities principals and 204 registered representatives.

The Sponsoring Firm has the following disciplinary history:

- In a 1999 AWC, the Sponsoring Firm, acting through the Firm's Chief Financial Officer and Financial and Operations Principal (ACFO/FINOP@), was found to have erred in calculating the amount of funds to be held in the Sponsoring Firm's 15c3-3 reserve account. The Sponsoring Firm and the Firm's CFO/FINOP consented to the imposition of a \$2,000 joint-and-several fine, and the CFO/FINOP consented to a censure and an additional \$7,500 fine.
- In 1999, NASD Regulation accepted a Letter of Acceptance of a Minor Rule Violation ("MRV") in which the Sponsoring Firm was found to have failed timely to report its short interest positions to the Association for a month in 1998, in violation of Conduct Rule 3360. The Sponsoring Firm consented to the imposition of a \$1,000 fine and agreed to revise its written supervisory procedures immediately to comply with Conduct Rule 3360.

- In a 1999 AWC, the Sponsoring Firm was found to have executed two short sale transactions and failed to report each of the transactions to the Automated Confirmation Transaction Service ("ACT") with a short sale indicator. In addition, the Sponsoring Firm failed to make an affirmative determination for the two transactions. This misconduct violated Conduct Rule 3370 and Marketplace Rule 6130. The Sponsoring Firm consented to a \$1,200 fine.
- In 1998, NASD Regulation accepted an MRV in which the Sponsoring Firm accepted and consented to findings that during a period in 1996 and 1997, the Sponsoring Firm submitted trade data after the specified due date in nine different instances. The Sponsoring Firm's submissions were four to nine days late. This conduct violated Schedule D, Part V, Section 4 of the NASD By-Laws and Schedule H, Section 3 of the NASD By-Laws. The Sponsoring Firm consented to a \$500 fine.

The Sponsoring Firm does not employ any statutorily disqualified individuals, and it is not a member of any other self-regulatory organization. The Sponsoring Firm proposes that the Proposed Supervisor would be assisted in supervising X by a Compliance Leader, and the Chief Trading Officer.

The Proposed Supervisor, however, understands that she is the person who is responsible for X's supervision. The Sponsoring Firm will implement the following supervisory procedures until such time as X is no longer statutorily disqualified:

- (1) The supervisory procedures of the Sponsoring Firm will be amended to establish clearly that the Proposed Supervisor is X's responsible supervisor;
- (2) X will conduct a securities business on behalf of the Sponsoring Firm only from the office where the Proposed Supervisor is physically located, at a desk near the Proposed Supervisor's;
- (3) X will not maintain any customer or discretionary accounts, and therefore will not generate any account forms or order tickets;
- (4) X will also not generate or receive correspondence. However, if X were to receive incoming correspondence, the Proposed Supervisor would review it;
- (5) The Proposed Supervisor will review X's purchase and sale blotter on a daily basis to determine whether any trends or other patterns exist that would imply improper sales practice violations. She will keep a written record evidencing her review and approval of all of these transactions;
- (6) The Proposed Supervisor will meet with X on a quarterly basis to review his transactions. A log shall be kept by the Sponsoring Firm of these meetings;

- (7) All customer 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 she took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. Documents pertaining to these complaints should be kept segregated for ease of review;
- (8) The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Director of Compliance that the Sponsoring Firm is in compliance with all of the above conditions of heightened supervision to be accorded X;
- (9) 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
- (10) The Sponsoring Firm will provide advance notification to Member Regulation of any change in X's Supervisor.

Member Regulation has represented that it has carefully evaluated and assessed the merits of the Firm's application, the requirements of the public interest in light of X's past disciplinary history, the Sponsoring Firm's history, and the supervision to be accorded X, and it recommends that X's application for association with the Sponsoring Firm be approved.

Discussion

After a thorough review of the facts, we approve X's association with the Sponsoring Firm. The sole disqualifying event before us is X's 1997 conviction for arson, which arose out of a fraternity prank that ultimately caused damage to two automobiles. X pleaded guilty in November 1997, and the conviction was entered in December 1997, at which time he was sentenced to 24 months' probation and ordered to pay a \$1,000 fine and \$300 in restitution.²

In reaching our determination, we have considered not only the facts and circumstances of X's conviction, but the facts and circumstances of a subsequent disciplinary matter that does not rise to the level of a disqualifying event. At the time of his arrest and conviction, X was employed by Firm B. When he submitted his Form U-4 in November 1997, X failed to report the arson charge and his November 1997 conviction. The record indicates that he failed to do so because his attorney had advised him that following his guilty plea, there was a real possibility that the prosecutor would not proceed with the felony charge or that the judge would reduce the felony to a misdemeanor at the

² We note that the probation ended in November 1999.

December 1997 hearing. X's attorney also advised him that under that state's law, neither the conviction nor sentence took effect until 30 days after the dates of their respective imposition. Following the sentencing hearing, however, even though the felony was not reduced, X failed to amend the Form U-4, and in an AWC issued in 1999, X was found to have failed to disclose the convictions on his Form U-4. He consented to a censure, a \$5,000 fine, and a three-month suspension from association with any NASD member.³

In evaluating the significance of the AWC, we have considered that Member Regulation does not oppose X's association with the Firm on the basis of his Form U-4 violation. Member Regulation called as a witness the NASD Regulation regional attorney ("Regional Attorney") who handled X's AWC. The Regional Attorney testified at the hearing that he believed that X had not intended to withhold information from the NASD, and that he had failed to report his conviction based on his lawyer's advice that the event could very possibly be reduced to a misdemeanor prior to entry of judgment. The Regional Attorney also noted that X had otherwise accepted responsibility for his actions which had had significant consequences, including his expulsion from college and the loss of his job at Firm B.

We have also considered that X, who is now 21 years old, was only 19 years old at the time of his conviction and has done everything possible since then to rectify his error and get on with his life, including receiving his undergraduate degree from a different university in 1999. The most important consideration, however, is that notwithstanding the formal disciplinary action against X for the Form U-4 violation, there was neither an allegation nor a finding that his omission was willful.

We have also considered the circumstances of X's proposed employment with the Sponsoring Firm. The Sponsoring Firm proposes to employ X as a general securities representative in the capacity of a proprietary trader. The Sponsoring Firm represents that X would be trading in a Firm proprietary account that would be assigned to him. X would initially be limited to trading 200 shares and five positions at any one time. This restriction would be relaxed over time as X proves his capability. X would be compensated by receiving a 60 percent payout on profits, and he would have no supervisory duties.

The Sponsoring Firm proposes that the Supervisor, a proprietary trading supervisor at the Firm, will be X's responsible Supervisor. The Sponsoring Supervisor became a registered representative in 1994 and a general securities principal in June of 1998.⁴ The Sponsoring Supervisor was initially hired

³ The three-month suspension has been served.

⁴ From February of 1995 through October 1995, the Proposed Supervisor was an international trader at Firm C. She was also an international trader at Firm D from May of 1992 through December of 1994. She acted in an unregistered capacity as an equities dealer at Firm E from August 1990 through February of 1992.

as a proprietary trader at the firm in March 1998, but has no trading responsibilities in her capacity as supervisor. The Proposed Supervisor is responsible for supervising 13 compliance leaders (who are Series 24 licensed general securities principals) and 78 proprietary traders. The Proposed Supervisor is also the head of the Registration/Human Resources Department for proprietary traders. The Proposed Supervisor stated that she will sit close to X and have daily meetings with him. The Proposed Supervisor will also check X's blotters and all correspondence and conduct a quarterly review of his activity. She will also evaluate the stocks he has selected to trade. There have been no disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

We conclude that the Sponsoring Firm and the Proposed Supervisor are qualified to supervise X, and that they have proposed an effective plan of supervision.

The NASD certifies that: (1) X meets all applicable requirements for the proposed employment; (2) the Sponsoring Firm is not a member of any other self-regulatory organization; and (3) X and the Proposed Supervisor have represented that they are not related by blood or marriage.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the registration of X as a general securities representative associated with the Sponsoring 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,

Joan C. Conley
Senior Vice President and Corporate Secretary