

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of the Association

of

X

as a

Registered Representative

with

The Sponsoring Firm

**Redacted Decision**

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

SD99001

On March 4, 1998, the Sponsoring Firm submitted an MC-400 application ("Application") to permit X<sup>1</sup>, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as a general securities representative.<sup>2</sup> In October 1998, 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"), President of the Sponsoring Firm. BK and JH appeared on behalf of the Department of Member Regulation ("Member Regulation").

X is subject to multiple statutory disqualifications that arose from the same misconduct. In 1978, X sold unregistered debt securities of Company 1, made fraudulent representations and provided false or misleading information to investors concerning the financial condition and assets of Company 1, failed to record sales of these securities, and charged customers excessive mark-ups. X engaged in this misconduct while acting as the President of a registered broker-dealer.

---

<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> The Application was originally submitted by Firm A, and then amended in 1998 to reflect a change in the sponsoring member firm from Firm A to the Sponsoring Firm. The Sponsoring Firm joined the NASD membership in 1998, and replaced Firm A as the applicant after Firm A decided to withdraw from membership.

As a result of this misconduct, X received the following discipline:

- In 1978, X was enjoined in a United States District Court from further violations of Sections 17(a) and 5(a and c) of the Securities Act of 1933 and Section 10(b), and Rule 10b-5 thereunder, of the Securities Exchange Act of 1934;
- In 1980, the Securities and Exchange Commission ("Commission") found that X willfully violated Sections 17(a), 5(a), 5(c) of the Securities Act of 1933 and Rule 17a-3 thereunder, as well as Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The Commission barred X in all capacities and revoked the registration of the broker/dealer of which he was President; and
- In 1982, X was convicted of three counts of mail fraud and one count of conspiracy in the same United States District Court. He was sentenced to five years' probation and fined \$10,000. He was discharged from probation in 1985.

Since the events surrounding his disqualifications, X has applied for and received approval to return to the securities industry.<sup>3</sup> In 1992, Firm B filed an application for X to become associated with that firm as a registered representative in a limited capacity. The NASD Board of Governors approved the application contingent upon the implementation of the following supervisory procedures: (1) X's supervisor was required to review all new accounts, correspondence, and order tickets prior to entry; (2) X was to meet weekly with his supervisor to review his business plan and account activity; (3) X was prohibited from maintaining discretionary accounts; and (4) X was required to work in the firm's home office.<sup>4</sup>

In 1996, Firm A filed an application for X to become associated as a registered representative in a limited capacity. The NASD Board of Governors approved that application conditioned upon supervision by the Supervisor, Vice President of Firm A, that would be similar in all material respects to the supervision previously approved in the 1992 Rule 19h-1 filing.

In 1998 Firm A decided to withdraw from membership due, in part, to disciplinary problems involving both Firm A and its former President. In 1992, Firm A consented to the entry of findings of violations of NASD Rules 2110, 3110, 3010, and Article IV, Section 8 of the NASD By-Laws, in that Firm A prematurely broke escrow regarding a contingent offering of limited partnership interests; failed

---

<sup>3</sup> X's first attempt to return to the industry was unsuccessful. In 1989, Firm C filed an application for X to become associated with that firm as a registered representative. The NASD Board of Governors denied that application.

<sup>4</sup> In 1994, the NASD issued a notice pursuant to Rule 19h-1, in which it recommended that the limitations on X's association with Firm B be lifted. The Commission took no action with respect to that Notice and the limitations on X's association with Firm B remained in place.

to disclose material information to investors; conducted a securities business while failing to maintain its minimum required net capital; failed to maintain accurate books and records; filed inaccurate FOCUS reports; failed to comply with its restrictive agreement; failed to register its branch offices; and failed to establish, maintain and enforce a supervisory system and written procedures to supervise the types of business in which it engaged. Firm A was censured, fined \$30,000, and ordered to pay \$7,500 in restitution.

In 1994, the NASD initiated a formal complaint against Firm A alleging violations of NASD Rules 2110, 3110, and 3070(a)(7), in that Firm A effected securities transactions while failing to maintain minimum required net capital and failed to comply with a provision of its restriction agreement; filed inaccurate FOCUS reports; failed to comply with the books and records requirements; failed to comply with Section 15(f) of the Commission's Insider Trading Act; and failed to establish, maintain and enforce written supervisory procedures. Firm A consented to the entry of findings of facts and violations and was censured and fined \$12,500.

In 1996, the NASD filed a complaint against Firm A and its former President for violating Conduct Rules 2110, 2120, and 3110(a)(7) by failing to maintain net capital compliance; failing to maintain accurate books and records; failing to prepare accurate monthly net capital computations; filing inaccurate FOCUS reports; failing to make required disclosures in an offering circular relating to limited partnership interests sold to customers; and failing to conduct required annual compliance meetings with two registered representatives.

In 1997, without admitting or denying guilt, Firm A and its former President consented to the entry of findings of facts and violations consistent with the allegations of the 1996 complaint. Firm A and its former President agreed to the following sanctions: Firm A and its former President were censured and fined \$40,000 jointly and severally, and the former President was also: (1) required, within 120 days of executing the offer, to requalify by examination as a general securities representative or else refrain from associating with any member until he has requalified by examination; (2) barred from association with any member of the Association in any principal capacity and from performing any principal, supervisory, or managerial functions with any member; and (3) barred from maintaining a proprietary interest in any member of the Association with certain exceptions.<sup>5</sup>

## Discussion

Member Regulation objects to X's association with the Sponsoring Firm in any capacity on three grounds: (1) the serious nature of the activities that created X's statutory disqualifications; (2) Firm

---

<sup>5</sup> Also, in 1996, Firm A consented to findings by the State 1 Securities Division that sales of securities were made by Firm A in State 1 while the firm was not registered with the state. State 1 issued a consent order in which Firm A was required to disclose to its customers that securities transactions were executed while the Firm was not registered, revise its supervisory procedures, and pay monetary penalties amounting to \$3,150.

A's prior disciplinary history; and (3) the ability of the Sponsoring Firm and the Supervisor to supervise effectively a statutorily disqualified individual. Based on the above, Member Regulation suggests that it is not in the public interest to allow X to associate with the Sponsoring Firm. After carefully considering these arguments and the record, we conclude that the Application should be approved.

Although X's violations were serious and securities-related, they no longer provide a basis for precluding his association with a member firm. In the 20 years since they occurred, X has committed no other violations, the NASD has three times recommended that X be permitted to associate with member firms, and he has been associated for six years without incident. Given these facts, X's prior misconduct provides no basis for denying the Sponsoring Firm's Application.

Nor does Firm A's prior disciplinary history provide sufficient basis to deny the Application. Firm A's disciplinary history is relevant because the Sponsoring Firm and Firm A, while separate legal entities, are substantially identical. Since 1997 the Supervisor has been the President of Firm A and he will be the President of the Sponsoring Firm. In addition, both firms are located at the same address, all of the registered representatives of Firm A have become dually registered with the Sponsoring Firm, and substantially all of Firm A's assets have been transferred to the Sponsoring Firm.

What distinguishes the Sponsoring Firm from Firm A, and simultaneously alleviates concerns about Firm A's disciplinary history, is that Firm A's former President will have no management or supervisory responsibilities with the Sponsoring Firm. The former President is the individual who was responsible for Firm A's violations, described above; the violations all occurred while this individual was Firm A's President. The Proposed Supervisor, the Sponsoring Firm's President, was not named in any of the disciplinary actions against Firm A and was not responsible for any of the violative conduct. Consistent with the terms of the 1997 AWC, Firm A's former President will be associated with the Sponsoring Firm as a registered representative and his three children will hold shares of non-voting stock in the Sponsoring Firm. We conclude, however, that the former President will not be in a position to commit supervisory violations or to cause the Sponsoring Firm to commit such violations. Therefore, we find that Firm A's prior disciplinary history provides no basis for denying the Application.

Finally, the Proposed Supervisor and the Sponsoring Firm are qualified to supervise X and they have proposed an effective plan of supervision:

- (1) X and the Proposed Supervisor will be located in close proximity at the Sponsoring Firm's home office;
- (2) X and the Proposed Supervisor will meet weekly to discuss X's assignments and business; and
- (3) The Proposed Supervisor will personally monitor and review X's correspondence, new accounts, and order tickets prior to entry.

The Sponsoring Firm has been an NASD member since 1998, and it employs no other individuals who are subject to statutory disqualification.<sup>6</sup>

Member Regulation argues that the Proposed Supervisor will be unable properly to supervise X because the Supervisor will be supervising 30 other registered representatives and also because the Supervisor has been a municipal securities principal for only one year.<sup>7</sup> The Proposed Supervisor has been registered with the Association as a general securities principal since 1990, a municipal securities principal since 1997, and a general securities representative since 1986. He has supervised X and Firm A's registered representatives since 1997 without incident, and there is no evidence that his short tenure as a municipal securities principal will materially affect his ability to supervise X.<sup>8</sup> The Supervisor will also be assisted with his other supervisory duties by Employee 1, a registered general securities, options, and financial and operations principal.

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 upon the issuance of an order by the Commission that it will not institute proceedings pursuant to Section 15A(g)(2) of the Act. The NASD is also seeking relief under SEC Rule 19(h) of the Act. This notice shall serve as an application for such an order.

On Behalf of the National Adjudicatory Council,

---

Joan C. Conley, Corporate Secretary

---

<sup>6</sup> Firm A's former President is statutorily disqualified in any supervisory or principal capacities, but he is not associated with the Sponsoring Firm in those capacities.

<sup>7</sup> Member Regulation was also concerned that Firm A's former President would be responsible for the operations of two firms and for supervising representatives that are registered with both firms. The Proposed Supervisor testified, however, that the two firms will not be operating simultaneously because Firm A's operations will cease on the same day that the Sponsoring Firm's commences.

<sup>8</sup> The Proposed Supervisor has committed one disciplinary violation. In 1994, the State 2 Bureau of Securities issued a complaint against the Proposed Supervisor alleging that from 1993 through 1994 Firm A and the Proposed Supervisor conducted transactions in State 2 while not registered with that state. This matter resulted from an administrative oversight and was settled for a small payment of fees.