

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of the Association	<b>Redacted Decision</b>
of	<u>Notice Pursuant to</u>
X	<u>Rule 19h-1</u>
as a	<u>Securities Exchange Act</u>
General Securities Representative	<u>of 1934</u>
with	SD99003
The Sponsoring Firm	

On July 17, 1998, a member firm ("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 Firm as a general securities representative. In December 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, Employee 1, a registered representative at the Sponsoring Firm, and Employee 2, Senior Vice President of the Sponsoring Firm. BK and DAB appeared on behalf of the Department of Member Regulation ("Member Regulation").

X is subject to a statutory disqualification arising from a 1990 felony conviction for driving under the influence in State 1 ("the 1990 Conviction"). X was sentenced to five years' probation and fined \$500. X had a previous felony conviction for driving under the influence in 1986 ("the 1986 Conviction"), for which he was sentenced to five years' probation, and fined \$500. Because the 1986 Conviction is more than 10 years old, this conviction no longer disqualifies X. The 1990 Conviction will cease to be a disqualifying event in 2000.

X became associated with NASD Member Firm A in 1987. He passed the Series 7 examination in 1988, and was approved by the New York Stock Exchange ("NYSE") as a general securities representative in 1988. The NYSE filed a notice of X's proposed continuance with Firm A in 1992 and received SEC approval in 1993. Although X had already been convicted of his second felony in 1992, the NYSE's Notice of Proposed Continuance referenced only the 1986 Conviction.

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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.

The record indicates that Firm A failed to amend X's Form U-4 to disclose the second conviction. Also, this information was not disclosed on X's Form U-4 when he joined Firm B in 1994. Following submission of X's fingerprint card, Firm B received a Department of Justice report indicating both felony convictions. In 1994, Firm B amended X's Form U-4 to report the 1990 conviction, and in 1994, the information was also entered on X's Central Registration Depository ("CRD") record.

The Sponsoring Firm, became a member of the Association in 1982. The Sponsoring Firm's main office is located in New York state. The Sponsoring Firm conducts a general securities business. It employs 1,073 registered representatives and 177 general securities principals.

During the last three years, the Sponsoring Firm has been the subject of two on-site examinations by NASD Regulation. The 1996 off-cycle municipal securities examination resulted in a 1997 letter of caution that cited the Sponsoring Firm for violations of MSRB Rules G-27, G-37, G-8, and G-9, as a result of the Sponsoring Firm's failure to properly report and record political contributions. The Sponsoring Firm was also cautioned to review its policies regarding municipal securities mark-ups and mark-downs.

The Sponsoring Firm's most recent routine examination, which began in 1998, resulted in a 1998 letter of caution that cited the Sponsoring Firm for the following: (1) The Sponsoring Firm was under reserved by approximately \$1,488,000 for a period ending in 1997 because the computer program used to compute the formula used entries for one date twice rather than new entries for the correct date.

The Sponsoring Firm had sufficient funds on hand in its operating account to cover the requirement, and when the Sponsoring Firm discovered the error the following week, it immediately filed the required telegraphic notice and implemented new review procedures to prevent a similar occurrence in the future.

(2) The Sponsoring Firm failed to report within 10 business days theft allegations against two registered representatives, who were subsequently terminated for cause. (3) Neither the Sponsoring Firm's head trader nor any of his three assistants had taken or filed to take the Series 55 Equity Trader examination.

The head trader later took and passed the examination and was executing all trades until the other individuals passed the examination.

In 1995, the State 2 Department of Banking issued an "Intent to Suspend Notice," which alleged that the Sponsoring Firm failed to supervise its agents in connection with the sale of real estate limited partnerships, and that the Sponsoring Firm operated three unregistered branch offices for whom no on-site manager had been designated. This matter was concluded in 1996, when the Sponsoring Firm agreed to hire a consultant to review the Sponsoring Firm's supervisory and compliance procedures. The Sponsoring Firm agreed to pay \$40,000, \$25,000 of which constituted a fine.

In 1985, the NASD issued a decision in which it found that the Sponsoring Firm had failed properly to supervise the activities of its office manager, and that the office manager had allowed employees under his supervision to use false and misleading sales literature in soliciting public customers to purchase securities. The Sponsoring Firm was fined \$10,000 and ordered to pay \$1,032.60 in costs, and also was required to provide the District Committee with a letter outlining the Sponsoring Firm's supervisory procedures.

## Discussion

The sole disqualifying event before us is X's 1990 felony conviction. Member Regulation opposes X's association with the Sponsoring Firm on the basis that he failed timely to update his Form U-4 during his employment with Firm A to reflect the 1990 Conviction, and also failed to report the 1990 Conviction on his Form U-4 at the time of his employment with Firm B. Member Regulation concluded that the NYSE failed to consider the 1990 Conviction in connection with X's continued association with Firm A because X had failed to report it to Firm A.

After a thorough review of the facts, we approve X's association with the Sponsoring Firm. It is undisputed that the two Forms U-4 in question did not timely reflect the 1990 Conviction. We have determined, however, that although X did not take affirmative steps to make sure that his Form U-4s were amended to reflect that conviction, he did not withhold this information from either Firm A and Firm B. We find that X did timely advise both firms that the conviction had occurred.

We find credible X's contention that he disclosed the 1990 conviction to his manager at Firm A, who informed him that this matter would be disclosed to the firm's compliance department. X's contention is corroborated by a co-worker who stated in a 1998 letter that she was present when X discussed the 1990 conviction with his manager. We also find credible X's contention that over the next several months, he provided additional information to his manager, which the manager forwarded to Firm A's compliance department. X's version of the events is supported by a memorandum from Firm A's Registration/Compliance Department from 1991, in which X was asked to comment on his disqualifications in anticipation of the NYSE application. X described two arrests, both of which resulted in "flony [sic] DWI's."

We also find credible X's contention that he advised Firm B of this conviction. X's co-worker corroborates X's contention. In her 1998 letter, the co-worker stated that she was in negotiations with Firm B at the same time that X was interviewing with the firm, and that the manager at Firm B who was interviewing X told her that the 1990 Conviction would "definitely not be a problem." X stated that he signed the Form U-4 when he began his employment at Firm B, but that he never noticed that the document did not disclose the 1990 Conviction. He stated that the document was one of many that he signed without reading carefully.

While we do not condone X's lack of diligence and his failure to carry out his responsibility to ensure that Firm A timely amended his Form U-4 and that Firm B initially reported the event on his Form U-4, we do not believe that this lapse warrants his exclusion from the securities business in light of the evidence that he timely disclosed this incident verbally to both firms.<sup>2</sup>

We have also considered that X has been attending Alcoholics Anonymous meetings and has represented that he has been substance-free for a year. The record includes a letter from his AA

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<sup>2</sup> Member Regulation also asked us to consider that in 1996, the NYSE admonished X, but determined not to take formal action against him, for what it determined were unsuitable recommendations (for which Firm B terminated X and settled with the customer for \$75,000), and also that X declared personal bankruptcy in 1991. We have concluded that these events do not warrant denying X's application.

sponsor who states that he has known X for approximately one year and that, to his knowledge, X has not had a drink during that time.

We find that the Sponsoring Firm's prior disciplinary history does not provide sufficient basis to deny the Application. In the MC-400, the firm indicates that the Proposed Supervisor will be the individual primarily responsible for supervising the activities of X. The Proposed Supervisor has been employed in the securities industry since 1980 and has been with the Sponsoring Firm since 1990. The Proposed Supervisor has been a general securities principal since 1990, and a municipal securities principal since 1993. We are not aware of any previous disciplinary events relating to the Proposed Supervisor, and he is not the subject of any open examinations and does not have familial relationship to X.

We approve the following plan of supervision, which was proposed by the Sponsoring Firm and approved by Member Regulation:

- 1) That X conduct a securities business on behalf of the Sponsoring Firm only from the office where the Proposed Supervisor is physically located, as represented in the MC-400 application. If X is to have a customer meeting outside the Sponsoring Firm offices, X must disclose the name of the client or prospect to the Proposed Supervisor, who will then contact a sample of these clients to ensure that X has conducted himself in an appropriate manner, and has complied with the Firm's rules and regulations.
- 2) That the heightened supervision of X by the Proposed Supervisor include, at a minimum, review and approval of every securities account opened by X, along with a review of all securities transactions executed by X with customers of the Sponsoring Firm.
- 3) That the Proposed Supervisor review and approve both incoming and outgoing correspondence for X, and review and approve any advertising drafted by X.
- 4) That the Proposed Supervisor keep a written record evidencing review and approval of all transactions, the opening of new accounts, and all correspondence and advertising for X.
- 5) That all customer complaints, verbal or written, be forwarded to the Proposed Supervisor for review. The Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint (i.e., contact with the customer) and the resolution of the matter.
- 6) That the Proposed Supervisor have quarterly meetings with X to review all aspects of his work and that such meetings be documented.
- 7) That X only be allowed to handle customer checks that are made payable directly to the insurance/annuity company or mutual fund sponsoring the product. X may also accept checks made payable to the Sponsoring Firm. X may not, under any circumstances, accept cash.
- 8) That X not be allowed to open or maintain any discretionary accounts.

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 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 in 30 days from the date of this notice.

On Behalf of the National Adjudicatory Council,

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Joan C. Conley, Senior Vice President and Corporate Secretary