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 SD99020

A member firm ("the Sponsoring Firm") has completed an MC-400 application ("Application") to permit X[1], a person subject to a statutory disqualification, to associate with the Firm as a general securities representative. In 1999, a subcommittee ("Subcommittee") of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") held a supplemental hearing on the matter. X and his proposed supervisor ("the Proposed Supervisor"), President of the Firm, participated in the hearing by telephone. BA appeared on behalf of the Department of Member Regulation ("Member Regulation").

Procedural History

We previously reviewed this matter and approved the Firm's Application in a 1999 decision. During the Securities and Exchange Commission's ("SEC" or "Commission") 30-day review period, SEC staff raised two questions about the Application. In response to these questions, we withdrew our original decision. Thereafter, the Subcommittee conducted a second hearing and also reviewed written responses that the Sponsoring Firm had provided in response to the SEC's questions.

[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.

Background

X entered the securities industry in 1963, and he was associated with Firm A from 1963 to 1989. X is subject to a statutory disqualification that arose from misconduct that occurred from late 1987 through early 1989 while he was the registered options principal at Firm A and managed that firm's main office in New York.

The SEC eventually brought two sets of court proceedings against X and several other Firm A employees based on the same misconduct: an action for injunctive relief in federal court and an SEC administrative action. Because both these actions are germane to the Sponsoring Firm's Application, we summarize both of them.

In 1986, Firm A hired Employee A-1 and Employee A-2, both registered representatives, who were "big producers."[2] In 1987, X took responsibility for supervising Employee A-1 and Employee A-2. In an administrative proceeding that the Commission initiated years later, the Commission alleged that -- from late 1987 to early 1989 -- X and others manipulated the trading in two securities. The Commission specifically alleged that:

1. X approved the processing of trades by Employee A-1 and Employee A-2 in Firm A's error account to avoid liquidating into the market vast quantities of Company 1 common stock that they had accumulated in their customer accounts;

2. X directed Employee A-1 and Employee A-2 to execute purchases of American Depository Receipts ("ADRs") of the Company 2 in customer accounts knowing that many of these customers had insufficient funds to pay for, and in many instances never paid for, the transactions;

3. X approved cross trades of Company 1 common stock and Company 2 ADRs between customer accounts, knowing that Employee A-1 and Employee A-2 were executing cross trades to avoid liquidating the Company 1 shares and Company 2 ADRs they had accumulated in their customer accounts;

4. X requested numerous extensions from Firm A's clearing firm in order to comply with Regulation T; and,

5. X approved the opening of new accounts by Employee A-1 and Employee A-2 in the names of customers with existing, persistent Regulation T problems knowing that Employee A-1 and Employee A-2 were creating multiple accounts in these customers' names to facilitate the parking of Company 1 common stock and Company 2 ADRs.

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[2] [Case redacted.]

The Commission filed a complaint for injunctive and other relief against Employee A-1 and Employee A-2 in a United States District Court in 1989, and amended that complaint on June 4, 1991, by adding Defendant 1, X, Defendant 2, Defendant 3, and Defendant 4 as defendants. The complaint alleged that from late 1987 through early 1989, Defendant 1, X, and Defendant 2 had manipulated the ADRs of Company 2 and that Defendant 1 and X had manipulated the shares of Company 1, in violation of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.[3]

In 1994, the court issued a "Final Judgment As To Defendant XX By Consent," which enjoined X from violations of Section 10(b) and Rule 10b-5. The court ordered X to disgorge $103,000, plus $66,201.53 in prejudgment interest, but X's payment was waived based on his demonstrated inability to pay. At the same time, X entered into a consent to final judgment, in which he neither admitted nor denied the allegations in the Commission's complaint.[4]

More than one and one-half years later, in 1996, the Commission filed an administrative complaint against X, Defendant 1, and Defendant 2 alleging that X had participated in manipulating the trading in Company 1 and Company 2, as described above. After holding a hearing and taking testimony, in 1997, the Administrative Law Judge ("ALJ") issued a decision, which became a final decision approximately six weeks later.[5]

The ALJ found that X had admitted his guilt at the hearing. She also found, however, that he did not realize any income from the trading by Employee A-1 and Employee A-2 in the securities of Company 1 or Company 2, his customers did not suffer any losses, and he had never been charged with any securities violations before the events at Firm A. Finally, the ALJ noted that the record contained several letters of support from persons active in the securities industry, customers, and friends. The authors of the letters attested to X's good character and stated that his continued participation in the securities industry presented no threat to the investing public.

The ALJ concluded that based on her "observation of the witness, [X's] testimony under oath, and the record evidence . . . [X's] participation in the securities business present[ed] no future threat to the investing public." She ordered that he be censured and barred from association with a broker or dealer in a supervisory or proprietary capacity. After the NASD reviewed this decision, the Sponsoring Firm submitted the Application to continue X's association with the Firm.[6]

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[3] 15 U.S.C. §78j(b) and 17 C.F.R. §240.10b-5.

[4] NASD Regulation staff, upon being informed of the 1994 judgment, incorrectly identified it as neither a final decision nor an otherwise statutorily disqualifying event, and staff therefore did not require X's employer to submit a membership continuance application at that time. See NASD, Inc. By-Laws, Art. 3, Sec. 4(h).

[5] [Case redacted.]

[6] The Commission's bar of X from acting in a supervisory or proprietary capacity is not statutorily disqualifying for X's Application to be employed as a general securities representative. Cf. NASD, Inc.

The Sponsoring Firm became a member of the NASD in 1989, and it conducts a general securities business. The Sponsoring Firm employs 24 registered representatives and two registered general securities principals, and it has two branch offices: one in France and the second in New Jersey. The Sponsoring Firm clears its transactions through Firm B. The Sponsoring Firm has no formal disciplinary history with the NASD. After a routine examination of the Sponsoring Firm in 1997, District No. 10 staff issued the Sponsoring Firm a Letter of Caution for allowing a Financial and Operations Principal ("FINOP") to act as a general securities principal, without being properly registered.

Discussion

After careful review of the entire record in this matter, we conclude that the Sponsoring Firm's Application to employ X as a general securities representative should be approved. We have considered X's conduct while associated with Firm A and assessed the SEC's two questions: Why did the Sponsoring Firm or X not file an MC-400 in 1994? And, does the Sponsoring Firm have another statutorily disqualified person associated with it? In addition, we note that Member Regulation has recommended that X's association with the Sponsoring Firm be approved.

Although X committed serious violations of the securities laws in the 1980s, we credit the ALJ's assessment of X's responsibility for the misconduct at Firm A because she listened to X's testimony about his guilt and also reviewed the U.S. District Court trial transcript. We find significant the ALJ's conclusions that X testified candidly at the U.S. District Court trial regarding the Company 2 fraud, including his role, and that his testimony "contributed significantly to the ultimate success of the Commission's case in District Court against Defendant 2." In addition, the ALJ concluded that X appeared to express genuine remorse for his role in the fraud. We further note that X has a long record of employment without regulatory misconduct before and after his statutorily disqualifying event.

As to the SEC's first question, we have examined why neither the Sponsoring Firm nor X initiated an MC-400 application in 1994, after the Federal District Judge entered a final judgment that included an injunction prohibiting future violations of the securities laws. The Sponsoring Firm has explained that it believed, mistakenly, that the Federal District Court action was only a part of a larger case, which included the SEC's administrative proceeding. The Sponsoring Firm and X have assured us that they would have made an MC-400 application earlier if they had understood that they should have. We accept their explanations and, based on the hearings the Subcommittee conducted, we find the explanations credible. In addition, we find no attempt by the Sponsoring Firm or X to conceal the events at issue. In fact, X disclosed the Federal District Court action against him in a Form U-4 that he filed in 1992, when he joined the Sponsoring Firm.

By-Laws, Art. 3, Sec. 4(b). The Court's 1994 "Final Judgment," which included an injunction against violating provisions of the securities laws, is the basis of the statutory disqualification at issue here.

The SEC's second question focused on the fact that in its Application the Sponsoring Firm disclosed an affiliation of some kind with another statutorily disqualified individual. While we have not conducted a full investigation into this affiliation, we are concerned that the Sponsoring Firm may have been allowing a disqualified individual to associate with the Firm. This matter should not, however, be resolved in this proceeding. The President of the Sponsoring Firm has submitted a sworn statement that the disqualified individual ended all affiliation with the Firm in March 1999, before any questions were raised about whether he was a disqualified individual associating with the Sponsoring Firm. The current Application, which we are approving, involves a Firm that currently employs no other statutorily disqualified individuals.

The Sponsoring Firm and the Proposed Supervisor have proposed the following plan of supervision for X:

(1) X and the Proposed Supervisor will be located in close proximity at the Sponsoring Firm's home office;

(2) X will conduct business on behalf of the Sponsoring Firm only from the office where the Proposed Supervisor is physically located;

(3) The Proposed Supervisor will conduct heightened supervision of X by, at a minimum, reviewing and approving of any transaction or other business on behalf of a the Sponsoring Firm customer whereby X serves as the Sponsoring Firm's representative;

(4) The Proposed Supervisor will keep a written record evidencing her review and approval of all transactions, the opening of new accounts, and correspondence; and

(5) The Proposed Supervisor will have quarterly meetings with X to review all aspects of his work.

The Sponsoring Firm appears to be well structured to supervise X in that it has proposed a program to monitor X closely, with daily on-site supervision by the Proposed Supervisor, who has no disciplinary history during her 35 years in the securities industry. We conclude that X will be sufficiently supervised to be associated with the Sponsoring Firm as a general securities representative.

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, X's association as a general securities representative with the Sponsoring Firm will become effective within 30 days of the receipt of this decision by the Commission, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

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Joan C. Conley
Senior Vice President and Corporate Secretary