

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of
the Association

of

X

as a

General Securities Representative

with

The Sponsoring Firm

Redacted Decision

Notice Pursuant to
Section 19(d)
Securities Exchange Act
of 1934

SD99011

In May 1998, a member firm ("the Sponsoring Firm" or "the Firm") submitted a Membership Continuance Application ("MC-400" or "the Application") to permit X¹, a person subject to a statutory disqualification, to continue to associate with the Firm as a general securities representative.² In January 1999, a subcommittee of the Statutory Disqualification Committee ("Hearing Panel") of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by his attorney, by his proposed supervisor, a general securities principal with the Sponsoring Firm ("the Supervisor"), and by the Firm's Director of Compliance. BA appeared on behalf of the Department of Member Regulation ("Member Regulation").

X's Background

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 The Sponsoring Firm clarified some earlier discrepancies in written submissions by stating at the January 1999 hearing that it was not requesting that X be permitted to continue to be associated with the Firm as a general securities principal.

X is subject to a statutory disqualification as a result of his 1997 guilty plea in a United States District Court to making and subscribing a false federal income tax return for the tax year 1994, a felony offense. The disposition of this case remains open and no sentence has yet been imposed on X³. The Plea Memorandum states that X "knowingly, intentionally, and willfully" failed to disclose or identify \$30,000 of income on his personal income tax return for the calendar year 1994.⁴ This income resulted from an agreement between X, then acting as the manager of a new broker/dealer known as Firm A, and the President of an issuer, Company 1, a publicly held company whose common stock traded in over-the-counter markets. Firm A was funded by Company 1's President and its financial public relations consultant, and Company 1's accountant owned the newly opened office of Firm A. According to the agreement, X would encourage brokers at Firm A to sell Company 1's stock to their customers, for which they would receive an extra 10 percent "commission." X received the commission money from Company 1's accountant. From April through August 1994, X received approximately \$30,000 in "overrides" on the extra "commissions" that Firm A brokers received.

X entered the securities industry in April 1990, and he passed the Series 7 examination in November 1990. Prior to his association with the Sponsoring Firm, which began in May 1995, he was associated with Firm B (April 1990 through July 1991); Firm C (June 1991 through May 1993); Firm D (May 1993 through February 1994); and Firm A (March 1994 through May 1995).

X has a prior disciplinary history. In 1994, State 1 fined X \$3,750 for effecting securities transactions in a state where he was not registered. In December 1995, a formal complaint was filed by NASD Regulation against X and others at Firm A. The complaint alleged that X had acted in a principal capacity without proper registration from April to December 1994 (this included the period during which X received the Company 1 "overrides").⁵ This resulted in a Letter of Acceptance, Waiver and Consent ("AWC") in 1996, in which X accepted a censure and \$5,000 fine. In 1997, a customer filed a complaint with the Sponsoring Firm, alleging unsuitable transactions by X. The matter was settled by the Firm for \$35,000, and no disciplinary action was taken against X. Also in 1997, a customer of the Sponsoring Firm complained to NASD Regulation that X had purchased stock for her

³ We affirm the Hearing Panel's determination to deny X's request for a postponement and to continue with this proceeding notwithstanding the fact that X has not yet been sentenced on his guilty plea and is scheduled to be a cooperating witness for the United States attorney in the underlying criminal trial in this action. This proceeding has been brought pursuant to the statute and rules which govern our self-regulatory process, and it operates independently of the criminal justice system. X's guilty plea to a felony offense constitutes a statutorily disqualifying event and we find that the public interest favors a resolution of his status in the securities industry.

⁴ In an amendment to his Form U-4, X stated only that he received \$30,000 in income in 1994, did not receive a Form 1099 for the income, and failed to report the income on his tax return. As set forth above, X admitted in the Plea Memorandum that when he filed the false income tax return, he did not believe the tax return was true and correct as to the material matter of his income.

⁵ X became registered as a general securities principal with Firm A in December 1994.

in a margin account without explaining what margin was and that he sold stock in her account to cover a margin call. NASD Regulation reviewed this complaint and found no merit; however, during the course of this investigation, it was discovered that X had failed, for three years, to notify the Central Registration Depository of a change of address. As a result, X was issued a Letter of Caution in March 1998.

We also note that X has two other criminal charges on his record. In 1989, he pleaded guilty in a State court to two misdemeanor charges, violating the maximum speed limit and operating a motor vehicle while impaired by alcohol. He was fined \$400 and his license was suspended. In 1995, he was arrested and charged with assault with intent to cause physical injury. Those charges were later dropped.

Background of Firm and Proposed Supervisor

The Sponsoring Firm is organized as a corporation. The Sponsoring Firm became an NASD member in 1987, and it is a market maker in Nasdaq equities, a mutual fund retailer, a municipal securities dealer, and an underwriter and selling group participant. The Sponsoring Firm employs 41 general securities representatives, 14 general securities principals, three investment company and variable contracts products representatives, three municipal securities principals, one municipal securities representative, three registered options principals, one corporate securities representative and two general securities sales supervisors. In addition to the main office, the Firm has two branch offices -- X is currently located at one of the branch offices. The Sponsoring Firm does not employ any other statutorily disqualified individuals.

From February through October of 1998, the Sponsoring Firm was the subject of seven customer complaints alleging high pressure sales tactics and/or false statements, misrepresentation, unauthorized transactions, and margin problems. Six of these customer complaints are currently being reviewed as separate inquiries by an NASD Regulation District Office, and one complaint (for misrepresentation) has been deferred. During this same period in 1998, four other exams were opened on the Firm: one termination-for-cause exam resulting from an alleged security forgery; and three other miscellaneous exams alleging free-riding, misrepresentation, and supervision violations. These exams are currently being reviewed as separate inquiries by an NASD Regulation District Office. None of the 1998 exams involve either X or the Proposed Supervisor, and they all stem from activities in the main office of the Sponsoring Firm.

The most recent routine exam of the Sponsoring Firm was conducted in 1997 and the findings are not yet conclusive. In 1996, NASD Regulation conducted an off-cycle municipal examination of the Firm which resulted in a Letter of Caution for violations of Municipal Securities Rulemaking Board ("MSRB") Rule G-27 regarding supervision and MSRB Rule G-37 regarding political contributions.

In 1994, a routine examination of the Sponsoring Firm resulted in a Letter of Caution. It was found that the Firm had not properly prepared its cash and securities received and forwarded blotters in accordance with Securities Exchange Rule 17a-3(a)(1); the Firm's net capital computation was not

prepared in accordance with Securities Exchange Rule 17a-3(a)(11); and certain of the Firm's new customer account records did not contain all of the required information.

In 1993, the National Credit Union Association ("NCUA") brought an action against the Sponsoring Firm alleging that a registered representative had sold it certain fixed income products in violation of NCUA's investment credit policy. The case was settled when the Sponsoring Firm paid \$35,000 to the NCUA.

The Sponsoring Firm proposes to have a general securities principal be X's direct supervisor at one of its branch offices. The Proposed Supervisor has worked in the securities industry since 1992, and he has been a general securities principal since January 1995. He was associated with Firm C (June 1992 through May 1993); Firm D (May 1993 through March 1994) and Firm A (April 1994 through May 1995). He has been associated with the Sponsoring Firm since June 1995. The Proposed Supervisor has an action pending against him by Firm D, a former employer, alleging the taking of proprietary property. There are no other actions on the Proposed Supervisor's record.

Member Regulation's Recommendation

Member Regulation opposed the Application basically on four grounds: 1) X's criminal conviction; 2) the fact that this conviction stemmed from "questionable practices" in the securities industry; 3) the NASD's 1995 finding that X was acting in a supervisory capacity at Firm A without appropriate registration, and X's attempts to downplay his supervisory role;⁶ and 4) the Sponsoring Firm's significant disciplinary history. In the alternative, Member Regulation proposed that if X were to be allowed to continue his association with the Sponsoring Firm, the Firm would have to implement certain specific supervisory procedures. At the hearing, the Sponsoring Firm agreed to adopt the procedures recommended by Member Regulation if its Application were approved.⁷

⁶ X argued that he was really acting at Firm A as a "business manager responsible for insuring the lights, computers and phones were all in working order as well as ordering supplies and insuring the sales force was working." Further, the Firm stated that X had been only 23 years old and inexperienced, and was "under the assumption that the additional commission was because of the relationship between [Company 1] and . . . [Firm A]."

⁷ The specific procedures were: that the Proposed Supervisor be named as the primary supervisor of X; that X conduct securities business on behalf of the Sponsoring Firm only from the office where the Proposed Supervisor is physically located; that the supervisory procedures of the Firm be amended to establish clearly the Proposed Supervisor's responsibility to supervise X; that the specific steps for heightened supervision of X by the Proposed Supervisor be written and incorporated into the Firm's written supervisory procedures; that the heightened supervision of X by proposed firm include, at a minimum, review and approval of any transaction or other business on behalf of a customer of the Sponsoring Firm whereby X serves as the Firm representative; that the Proposed Supervisor keep a written ledger evidencing review and approval of all transactions, the opening of new accounts,

Discussion

After a careful review of the entire record in this matter, we deny the Sponsoring Firm's Application for X to remain associated as a general securities representative. Like Member Regulation, we are concerned with X's very recent and serious criminal conviction. He pleaded guilty in February 1997 to a knowing and willful felony offense of filing a false federal income tax return for the tax year 1994. Such misconduct cannot be condoned, particularly in the highly-regulated securities industry, whose participants must demonstrate high levels of integrity in dealing with public investors and their funds.⁸

In addition, we are troubled by the 1996 AWC against X for acting in a principal capacity without proper registration at Firm A from April to December 1994, which includes the April to August 1994 period of Company 1 extra "commissions" and "overrides." Despite X's attempts to downplay his role at Firm A, he was accepting overrides on the representatives' commissions and it appears that he was in a management position at that firm during the time when Company 1 was making the questionable payments to X to have the representatives promote its stock.

We also note the Sponsoring Firm's disciplinary history, which ranges from recent securities-related customer complaints to various operational and supervisory problems found during previous examinations conducted by the Association. We thus conclude that even with the agreed-upon supervisory procedures outlined above, X should not be permitted to continue to associate with the Sponsoring Firm as a registered representative.

and correspondence; and that the Proposed Supervisor have monthly and quarterly meetings with X to review all aspects of his work.

⁸ Having concluded that X's misconduct was very serious, we reject as unpersuasive and irrelevant his arguments that the United States attorney could have charged him with offenses instead of, or in addition to, the false tax return submission -- *i.e.*, securities fraud. X contended that he has fully cooperated with the prosecution in the underlying criminal action, and that the prosecutors believed that his misconduct was inconsequential in relation to the actions of the "major players." We are not making findings here as to the relative culpability of the various offenders, or the prosecutorial decisions made by the United States attorney in the criminal action. Rather, we are dealing in this matter with the 1997 guilty plea of X and the activities in which he was engaged at Firm A, as described in the Plea Memorandum, that led to his admission of a knowing, intentional, and willful failure to disclose or identify \$30,000 in income on his personal income tax return for 1994.

For these reasons, given proper regard for the public interest and the protection of investors, we find that it is not appropriate for X to be associated in any manner with the Sponsoring Firm.

On Behalf of the National Adjudicatory Council,

Alden S. Adkins
Senior Vice President and General Counsel