

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of  
the Association of  
  
X  
  
as a  
  
General Securities Representative  
and Equity Trader  
  
with  
  
The Sponsoring Firm<sup>1</sup>

**Redacted Decision**

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

Decision No. SD01002

On January 10, 2001, the Sponsoring Firm (or "the Firm") completed an MC-400 application ("Application") seeking to permit X, a person subject to a statutory disqualification, to associate with the Firm as a general securities representative and equity trader. A hearing was not held in this matter. Rather, pursuant to NASD Procedural Rule 9523, NASD Regulation's Department of Member Regulation ("Member Regulation") recommended to the Statutory Disqualification Committee that X's proposed association with the Sponsoring Firm be approved pursuant to the terms and conditions set forth below. The Sponsoring Firm consented to the imposition of these terms and conditions in its MC-400 application.

X's Statutorily Disqualifying Event. In 1999, the United States Securities and Exchange Commission ("SEC" or "Commission") instituted proceedings against X and others, pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"). Contemporaneously, X and others submitted offers of settlement, which the Commission determined to accept. The SEC then issued an Order Making Findings and Imposing Sanctions ("Order"), also in 1999. The Order found that X willfully aided and abetted and caused violations of Sections 15(c)(1) and (2) of the Exchange Act and Rules 15c1-2 and 15c2-7 thereunder. On the basis of these findings, X was ordered to cease and desist from committing or causing any violation or future violation of Sections 15(c)(1) and (2) of the Exchange Act and Rules 15c1-2 and 15c2-7 thereunder. He was also ordered to pay a civil penalty in the amount of \$210,000 and was barred from association with any broker, dealer, municipal

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<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.

securities dealer, investment adviser or investment company, with the right to reapply for association after 18 months to the appropriate self-regulatory organization.

X was one of 51 individuals (along with 28 broker-dealers) sanctioned by the SEC for violations resulting from market making activities in the Nasdaq Stock Market ("Nasdaq"). Specifically, X was found to have aided and abetted the manipulative coordinated entry of quotations in market making transactions on Nasdaq and the entry of fictitious quotations in market making transactions on Nasdaq.

The SEC bar with the right to reapply after 18 months expired in July 2000. The civil penalty was paid in the amount ordered.

X's Background. X was registered with a member firm as a general securities representative from 1984 until December 1997. After being employed at another member firm as a trader from January to February 1998, X was a consultant at a third firm from June to December of 1998. He has since been a full-time student at a University. We are not aware of any other regulatory or disciplinary actions taken against X.

The Sponsoring Firm. The Sponsoring Firm became a member of the Association in July 1995. The Firm has two offices of supervisory jurisdiction and two branch offices. The Sponsoring Firm employs 93 registered principals and 438 registered representatives. It is a leading wholesale market maker in Nasdaq/OTC securities.

The Firm's 2001 routine examination has been scheduled, but has not commenced.

In 1999, NASD Regulation accepted the Sponsoring Firm's Letter of Acceptance, Waiver and Consent ("AWC") for effecting transactions in a particular security while a Nasdaq trading halt was in effect in that security. This was a violation of NASD Rules 3340 and 2110. The Firm was fined \$1,000.

In 1999, NASD Regulation accepted the Sponsoring Firm's AWC for violations of NASD Rules 6740 and 2110. The Firm submitted four orders to Instinet after the stock was halted for trading. For this misconduct, it was censured and fined \$5,000.

In 1998, NASD Regulation accepted the Sponsoring Firm's AWC for violations of NASD Rules 6130, 3350 and 3370. The Firm executed 116 short sale transactions without identifying those trades as short sales in the Automated Confirmation Transaction System ("ACT"); it executed four short sale transactions in Nasdaq National Market securities at or below the preceding inside bid when the current inside bid was below the preceding inside bid in each of the securities; and it executed 21 short sale transactions without making an affirmative determination for each of the transactions. For this misconduct, Knight was censured and fined \$10,000.

In 1997, the Sponsoring Firm's AWC was accepted for violations of SEC Rule 11Ac-1 (the "Firm Quote Rule"), NASD Conduct Rules 2110, 3010 and 3320, and NASD Marketplace Rule 4613(b). The Firm failed to execute 28 orders that were presented to the Sponsoring Firm at its published bid or published offer, and therefore failed to honor its published quotation. The Sponsoring Firm also failed to establish, maintain and enforce written supervisory procedures to ensure compliance with these rules. The Firm was censured and fined \$5,500.

In 1997, the Sponsoring Firm was notified that its AWC was accepted. The Firm was found to have violated NASD Rule 4613(d) for entering quotations in Nasdaq that exceeded the parameters for maximum allowable spreads. The Sponsoring Firm was fined \$1,000 and required to conduct a compliance conference.

In 1997, the Firm was notified that its AWC was accepted by the National Business Conduct Committee. The Sponsoring Firm was found to have violated SEC Rules 17a-3 and 17a-4, and NASD Rules 2110 and 3010 by failing to create and maintain a record of customer limit orders and for failing to enforce written supervisory procedures designed to prevent these violations. The Firm was fined \$2,000.

In 1997, the Sponsoring Firm was notified that its AWC was accepted by the National Business Conduct Committee. The Sponsoring Firm was found to have violated Rule 4613(d) for entering quotations in Nasdaq National Market system securities that exceeded the parameters for maximum allowable spreads in three securities. The Firm was fined \$2,000 and was required to conduct a continuing education class. Also in 1997, by an AWC, the Firm was fined \$6,000 and censured for violations of NASD Rules 3010, 2110 and IM-2110-2 for late and non-execution of customer limit orders and for failing to have written supervisory procedures designed to prevent such violations.

The Sponsoring Firm was notified in 1997 that its AWC was accepted by the National Business Conduct Committee. The Firm was found to have violated NASD Rule 4613(E) by entering or maintaining quotations in the Nasdaq Stock Market during normal business hours which caused a locked market condition to occur in two securities. The Firm was fined \$2,000.

In 1996, the NASD's National Business Conduct Committee accepted an AWC on behalf of the Sponsoring Firm. The Firm was found to have violated NASD Rules 2110 (by executing day limit orders after the orders had expired) and 3010 (by failing to establish, maintain and enforce written supervisory procedures that would detect and deter these violations). For this misconduct, the Firm was censured, fined \$50,000 and required to pay restitution to customers in the amount of \$166,230.

X's Business Activities and Supervision. X will work out of the Firm's home office. He will be trading a group of Nasdaq/OTC securities, will have no supervisory functions, and will be compensated with a salary plus annual incentive bonus.

The Proposed Supervisor will be X's primary responsible supervisor. The Proposed Supervisor, who has been a general securities representative since 1983 and a general securities principal since 1995, works out of the Firm's home office. The Proposed Supervisor has no disciplinary history. The Proposed Supervisor has acknowledged his responsibilities as X's designated supervisor. The Proposed Supervisor will receive some assistance from SL, who has been a general securities representative since 1985 and a general securities principal since February 1999. SL, who is the Sponsoring Firm's trading room manager, also has no disciplinary history.

Member Regulation and the Proposed Supervisor have agreed that the following terms and conditions will govern X's association with the Sponsoring Firm as a general securities representative and equity trader:

1. X will be located in the same office as the Proposed Supervisor. The Proposed Supervisor and X will be seated in close physical proximity of each other in the office.
2. X will act primarily as a trader (i) executing orders that exceed quantities that are executed automatically by the Sponsoring Firm's systems and (ii) managing inventories and risk. X will not be able to turn off his automatic execution function unless he has sought and obtained permission from the Proposed Supervisor or a manager on the trading floor.
3. All of X's business will be broker-to-broker and he will not have direct dealings with the general public or institutional customers. X therefore will not interact with any customer or discretionary accounts. Since all trading in Nasdaq stocks between market makers, ECNs, and UTPs is electronic, i.e., through SelectNet or SOES, there typically will not be a need for X to speak on the telephone to a contra party. In the event, however, that X needs to speak with another market participant, he first will seek the approval of the Proposed Supervisor or another trading room manager if the Proposed Supervisor is absent. Any such telephone calls will be monitored randomly to ensure adherence to NASD Rule 2110 and, in particular, IM-2110-5.
4. X will be subject to, and required to abide by, the normal supervision of registered representatives by the Sponsoring Firm supervisors.
5. On a daily basis, the Proposed Supervisor will review exception reports that will note any violations by X of the SEC's Firm Quote Rule (SEC Rule 11Ac-1) and the NASD's rule concerning locked and crossed markets, trade or move, and trade or fade (NASD Rule 4613). The Proposed Supervisor shall maintain copies of all statements reviewed and shall

record on such statements the date of his review. In addition, the Proposed Supervisor will be able to monitor on a random basis X's positions throughout the day.

6. The Proposed Supervisor will have weekly meetings with X to review all aspects of X's work at the Firm, including compliance with the Firm's policies and procedures. The Proposed Supervisor shall maintain a record of the various matters discussed and reviewed with X during such weekly meetings.
7. On at least a monthly basis, SL or another deputy trading room manager will review the Proposed Supervisor's supervision of X, including the records of such supervision.
8. All complaints pertaining to X, whether written or verbal, will be immediately reviewed by the Proposed Supervisor. The Proposed Supervisor will immediately forward all complaints to SL with a copy to the compliance department.
9. The supervisory procedures of the Sponsoring Firm will be amended to specify the Proposed Supervisor as the responsible supervisor for X, and will include the special supervisory program set forth above.
10. 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.

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 and equity trader should be approved, subject to the terms and conditions set forth above.

In reaching this determination, we have considered that in 1999, when the SEC imposed the bar on X with the right to reapply after 18 months, the Commission was charged with weighing the requirements of the public interest in light of X's misconduct. The Commission concluded that it was appropriate to allow X to apply for association with a broker-dealer after 18 months. Accordingly, in reviewing this application, NASD Regulation follows the guidance set forth by the Commission in Paul Van Dusen, 47 S.E.C. 668 (1981) and Arthur H. Ross, 50 S.E.C. 1082 (1992). Van Dusen and Ross require that, in Commission enforcement actions in which a right to reapply is specified, an application submitted after the specified term should be granted, absent other acts of misconduct or circumstances of record bearing adversely on a firm or a sponsored person's fitness to re-enter the securities industry. Accordingly, NASD Regulation focuses its inquiry on any "other [intervening] misconduct in which the applicant may have engaged, the nature and disciplinary history of a prospective employer, and the supervision to be accorded the applicant." Van Dusen, at 671.

The record does not reveal any misconduct by X after the entry of the SEC's Order. The Firm has agreed to extensive, well-structured supervisory controls that will govern X's activities. Further, the Proposed Supervisor, who has extensive supervisory experience and no regulatory disciplinary history, appears to be fully capable of supervising X's activities. Given these three factors, NASD Regulation believes that the Sponsoring Firm's disciplinary history, especially given the relatively large size of the Firm and the numerous transactions it engages in on a daily basis, is not of such concern as to call into question the Firm's ability to supervise X.

Given the terms of X's 1999 settlement with the Commission, we conclude that the Sponsoring Firm's Application satisfies the conditions necessary for X to re-enter the securities industry in the agreed-upon capacity, and that the public interest will not be jeopardized by X's association with the Sponsoring Firm.

NASD Regulation certifies that: 1) X meets all applicable requirements for the proposed employment; 2) the Firm is not a member of any other self-regulatory organization; 3) X and the Proposed Supervisor have represented that they are not related by blood or marriage; and 4) the Firm does not employ any other statutorily disqualified individuals.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the association of X as a general securities representative and equity trader 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 Section 19(h) of the Act. This notice shall serve as an application for such an order.

On Behalf of the National Adjudicatory Council,

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Joan C. Conley  
Senior Vice President and Corporate Secretary