BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of Department of Market Regulation, Complainant, vs. Castle Securities Corp. Freeport, New York, Respondent.	DECISION Complaint No. CMS030006 Dated: February 14, 2005

Member firm appeals Hearing Panel decision finding that it: (1) failed to submit required information to the Order Audit Trail System ("OATS"); (2) failed to establish supervisory procedures designed to achieve OATS compliance; and (3) failed to comply with Automated Confirmation Transaction Service ("ACT") requirements. Held, findings affirmed and sanctions modified.

Appearances

For the Complainant: Timothy B. Nagy, Esq., Jeffrey K. Stith, Esq., NASD Department of Market Regulation.

For the Respondent: Michael T. Studer, pro se, on behalf of the corporation.

DECISION

Pursuant to Procedural Rule 9311, Castle Securities Corp. ("Castle" or "the Firm") appeals a December 3, 2003 NASD Hearing Panel decision in which the Hearing Panel found that Castle failed to: submit required information to the Order Audit Trail System ("OATS"); comply with the requirements of the Automated Confirmation Transaction Service ("ACT"); and establish supervisory procedures designed to achieve OATS compliance. The Hearing Panel fined Castle $80,000 and suspended the Firm for 10 business days or until implementation of NASD-approved supervisory procedures. After a thorough review of the record, we affirm the Hearing Panel's findings, but modify the sanctions. We fine Castle $80,000, suspend the Firm for 30 business days or until implementation of NASD-approved supervisory procedures, and impose costs.

I. Background

Castle was an NASD member from 1985 until October 2003 when it withdrew its NASD membership. Castle is one of several subsidiaries of Castle Holdings Corporation ("Castle

Holdings"), a publicly held company. Michael T. Studer ("Studer") was president and treasurer of Castle during the relevant periods. Studer participated in this appeal on behalf of Castle.

II. Factual Findings

A. Background on OATS

In 1998, the Securities and Exchange Commission approved NASD's OATS rules (NASD Rules 6950 through 6957).[1] The effective dates for the OATS rules varied for different types of member firms and different types of orders. Accordingly, NASD's implementation of the OATS reporting system is occurring in three phases.[2]

B. Facts Related to Castle's OATS Violations

On July 6, 1999, Castle submitted to NASD an OATS Subscriber Initiation and Registration Form in which it registered for phase two of implementation. NASD notified Castle via NASD's OATS Internet Website that Castle's scheduled date to commence OATS reporting was September 15, 1999.[3] During the period from September 15, 1999, through June 16, 2000, Castle received, originated, or transmitted orders in Nasdaq securities via an electronic order routing or execution system but failed to submit required order information to OATS.

On June 7, 2000, NASD advised Castle that it had failed to transmit required order information in accordance with Rule 6955. On June 19, 2000, Castle submitted the missing OATS data. By letter dated June 21, 2000, Studer advised NASD that Castle had an oral

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[1] Exchange Act Rel. No. 39729, *Order Approving Proposed Rule Change to Adopt New Rules 6950 Through 6957 Relating to the Creation of an Order Audit Trail System*, 1998 SEC LEXIS 395 (Mar. 6, 1998). NASD created the OATS system in response to an SEC ruling directing NASD to design and implement an order audit trail system for purposes of heightened market surveillance. *See In re Nat'l Assoc. of Sec. Dealers, Inc.*, 52 S.E.C. 875, 880 (1996).

[2] *See NASD Notice to Members 98-73* (Firms Required to Register for Order Audit Trail System; Amendments to OATS Rules), 1998 NASD LEXIS 88 (Sept. 1998). Implementation of phase one commenced on March 1, 1999, for electronic orders from market makers and electronic communications networks. Implementation of phase two commenced on August 1, 1999, for all electronic orders in Nasdaq securities from all member firms. *Id.* An implementation date for phase three for all manual orders in Nasdaq securities is pending review before the Commission. *See* File No. SR-NASD-00-23.

[3] NASD Rule 6955(a) states that all applicable order information required to be recorded under Rule 6954 shall be transmitted to OATS by each reporting member firm or a reporting agent. Rule 6954 requires reporting member firms to record order information, including date received, identification symbol, market participant symbol, number of shares, designation of buy or sell, and other information.

agreement with Galaxynet, Inc. ("Galaxynet"), an affiliate of Castle Holdings, to assist the Firm with transmission of OATS data.[4]

Again during the period from October 19, 2000, through December 7, 2000, the Firm failed to transmit to OATS required data because Castle's OATS password had expired.[5] NASD notified Castle of the delinquency on December 8, 2000, and Castle resumed OATS reporting on that day.

C. Facts Related to Castle's OATS Supervisory Failures

Castle's written supervisory procedures during the relevant period indicated that the Firm maintained proprietary OATS collection software that transmitted information to Nasdaq. The procedures stated that the Firm's "OATS reporting manager" would monitor the Firm's submissions. The procedures also stated that the Firm's "OATS supervisor" was responsible for maintaining and changing the Firm's OATS password every 60 days. The procedures indicated that the Firm's OATS reporting manager would conduct a "review of the system" quarterly and maintain a written report of the review.[6] The procedures did not otherwise address the Firm's compliance with OATS requirements.

D. Facts Related to Castle's ACT Violations

ACT is an automated system owned and operated by The Nasdaq Stock Market. For the ACT trades at issue in this case, Castle was obligated to review the trade data submitted by the contra side of each trade and accept or decline the trade or submit its own version of the trade. For such trades, the ACT system determines when a trade is "locked-in" by the receipt of an acceptance or by matching the information submitted by both sides to the trade.[7] ACT submits "locked-in" trades to the National Securities Clearing Corporation ("NSCC") for clearance and settlement, and transmits other trade information to member firms and regulators.[8] In general,

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4 Rule 6955(c) states that a reporting member may enter into an agreement with a reporting agent to satisfy its obligations under Rule 6955. Rule 6955 requires, however, that such agreements be *evidenced in writing* and states that, notwithstanding such agreements, the reporting member remains primarily responsible for compliance with the rule's requirements.

5 Castle's OATS password had expired on October 18, 2000, and OATS rejected all of Castle's data submissions after that date. Castle did not detect that its OATS password had expired until NASD notified it of the expiration.

6 Castle's supervisory procedures identified Tony Kafeiti ("Kafeiti") as the OATS reporting manager and Studer as the OATS supervisor.

7 *See* NASD Rules 6120-6190. NASD Rule 6130(b) states, in part, that ACT participants shall use the "browse" function in ACT to accept or decline trades within 20 minutes after execution.

8 NASD Rule 6110(d).

for the types of transactions at issue in this case, if a party that is required to accept or decline a trade fails to do so within 20 minutes, the system automatically locks in the trade on the following business day.[9]

Between October 1, 2001, and December 31, 2001, Castle failed to accept or decline 1,399 trades in ACT within 20 minutes or less of execution of the trade. By letter dated February 13, 2002, NASD staff advised Castle that it had not accepted or declined within 20 minutes of execution more than 83% of all transactions in which Castle was required to report in ACT. By letter dated March 14, 2002, Castle responded to NASD staff that Rule 6130 is ambiguous, that no customers were harmed (because trades not confirmed by the second day were automatically deemed accepted), and that Castle's clearing firm had refused to provide acceptance services for Castle.

III. Procedural History

On January 24, 2003, NASD's Department of Market Regulation issued a three-cause complaint against Castle. Castle filed an answer to the complaint and requested a hearing. On April 28, 2003, Market Regulation filed a motion for summary disposition. On May 20, 2003, the Hearing Panel denied the motion without prejudice. The Hearing Panel held a hearing on June 11, 2003. At the conclusion of the hearing, the Hearing Panel granted Market Regulation's request for summary disposition as to liability and ordered the parties to submit post-hearing briefs on the issue of sanctions. The Hearing Panel issued a written decision on December 3, 2003, in which it found that Castle violated NASD's OATS, ACT, and supervisory rules as alleged and imposed sanctions. Castle thereafter appealed.

IV. Findings of Violation

Based on the record before us, we affirm the Hearing Panel's findings of violation.[10]

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[9] NASD Rule 6140(d).

[10] At the July 27, 2004, NAC appeal hearing, Castle disputed the sanctions that the Hearing Panel imposed, but not the findings of violation. In Castle's appeal brief, however, the Firm also argues that the record does not support the Hearing Panel's findings. We therefore address in this decision not only sanctions, but also our reasons for affirming the Hearing Panel's findings.

Castle also argues that Market Regulation staff improperly intimidated a registered individual identified as a potential witness for Castle. We reject Castle's argument. The record indicates that NASD staff did nothing more than contact an individual listed as a potential witness on Castle's witness list. NASD's procedural rules do not preclude NASD staff from contacting individuals listed as potential witnesses for the respondent. Castle contends that the witness decided, after Member Regulation staff contacted him, not to appear on behalf of Castle as a witness. Castle offers no evidence to support this contention, however, and did not request that NASD invoke its authority under NASD Rule 8210 to compel the witness's appearance. *See*

[Footnote continued on next page]

A. OATS Reporting Violations

NASD Rule 6955 requires member firms to transmit electronic order information to OATS. NASD Rule 6956 states that the failure of a member firm to comply with the requirements of Rules 6951 through 6957 may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade and a violation of Rule 2110. Castle submitted an OATS Subscriber Initiation and Registration Form and registered with OATS to participate in phase two of the implementation. NASD notified Castle via NASD's OATS Internet Website that its commencement date for electronic OATS reporting was September 15, 1999. Yet, Castle failed to submit the required order information to OATS for the first 191 consecutive business days after its scheduled reporting date. Thereafter, after four months of reporting, Castle again lapsed into noncompliance for a second period of 35 consecutive business days because it allowed its OATS password to expire. Castle's 1999 and 2000 failures to submit required information to OATS violated NASD Rules 2110 and 6955.

Castle argues that it was unfamiliar with the OATS reporting requirements, that NASD did not provide sufficient guidance to its members on OATS, and that Castle had delegated its reporting responsibilities to Galaxynet. We reject these arguments as defenses to Castle's failures to report trades.

As a member firm, Castle cannot shift its responsibility for complying with OATS reporting requirements to NASD. *See Stephen J. Gluckman*, 54 S.E.C. 175 (1999) (respondent cannot shift responsibility for understanding and complying with NASD rules to NASD staff); *Thomas C. Kocherhans*, 52 S.E.C. 528 (1995) (same). Nevertheless, NASD offered Castle and other NASD members significant guidance and instruction regarding OATS compliance. Immediately after the SEC approved NASD's OATS rules in March 1998,[11] NASD published Notice to Members 98-33, in which it summarized the newly approved OATS rules, explained how member firms could comply with the rules, indicated when implementation of the OATS system would commence, and provided information on NASD's "OATS Support Center," which the Notice to Members described as a primary source of OATS information for all NASD member firms. *See NASD Notice to Members 98-33* (SEC Approves New Order Audit Trail System), 1998 NASD LEXIS 44 (Mar. 1998). Thereafter, NASD published additional Notices to Members to remind NASD member firms of their OATS reporting obligations. *See NASD Notice to Members 99-27* (Order Audit Trail System Phase 2 Firms Required to Register), 1999 NASD LEXIS 97 (Apr. 1999); *NASD Notice to Members 98-73* (Firms Required to Register for

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NASD Rule 9252 (establishing standards for respondents who request that NASD invoke Rule 8210 to compel testimony or the production of documents).

[11] *See* Exchange Act Rel. No. 39729, *Order Approving Proposed Rule Change to Adopt New Rules 6950 Through 6957 Relating to the Creation of an Order Audit Trail System*, 1998 SEC LEXIS 395 (Mar. 6, 1998).

Order Audit Trail System), 1998 NASD LEXIS 88 (Sept. 1998). NASD also provided OATS subscribers with an OATS Subscriber's Manual, and NASD's OATS Internet Website during the relevant period included "OATS Frequently Asked Questions." *See* http://www.nasdr.com/3320.asp. Finally, NASD notified Castle of the Firm's commencement date for OATS reporting.

We also reject Castle's argument that it was not responsible for its own OATS reporting because Galaxynet had agreed to assume responsibility for the Firm's OATS reporting. NASD Rule 6955(c) provides that reporting members may enter into agreements with reporting agents pursuant to which reporting agents agree to fulfill the obligations of reporting members under NASD's OATS rules. Rule 6955 also provides, however, that any such agreement must be evidenced in writing and that each reporting member remains primarily responsible for compliance with the requirements of the OATS rules notwithstanding the existence of any such agreement.[12] Castle represented that it had an oral agreement with Galaxynet but provided no evidence of any written contract. In any event, even if Castle had produced evidence of a written contract with Galaxynet, Castle would have remained primarily responsible for its own OATS reporting.

Studer testified that the second lapse resulted from a change in personnel at the Firm and stated that the replacement person assigned to the position did not appreciate the importance of OATS reporting. Studer's arguments are unavailing. NASD's OATS Internet Website and the OATS Subscriber Manual provide information on how a subscriber can identify a rejected report, monitor report status, and change its password. Both also advise OATS subscribers that OATS passwords expire routinely (approximately every 60 days). Furthermore, Castle's own supervisory procedures state that Studer, as Castle's OATS supervisor, would change the Firm's password every 60 days. Studer testified before the Hearing Panel, however, that he still had not familiarized himself with NASD's OATS Internet Website. Castle should have known that its password had expired and that the OATS system had rejected the information it attempted to submit because of the expired password.[13]

Castle failed to submit required OATS information for a total of 226 business days in 1999 and 2000, in violation of NASD Rules 2110 and 6955, as alleged in cause one of the complaint.

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12 *See also NASD Notice to Members 98-33*, 1998 NASD LEXIS 44, at *4 (emphasizing that member firms are responsible ultimately for ensuring compliance with OATS rules).

13 Castle also argues that NASD is responsible for Castle's OATS violations because NASD staff failed to detect and notify Castle earlier of the Firm's noncompliance. This argument is without merit. "Applicants may not shift responsibility for their rule violations to [NASD] for providing inadequate guidance." *East/West Sec. Co.*, 54 S.E.C. 947, 951 (2000). Castle bore sole responsibility for its OATS reporting failures.

B. Castle's OATS Supervisory Violations

NASD Rule 3010 requires NASD members to establish and maintain a supervisory system and written procedures reasonably designed to supervise the activities of the firm's associated persons and to achieve compliance with applicable securities laws and regulations. "Beyond compliance guidelines, member firms must also adopt written supervisory procedures that describe the actual supervisory system established by the firm to achieve compliance with applicable rules and regulations." *NASD Notice to Members 98-96* (NASD Elaborates on Member Firms' Supervision Responsibilities for Trade Reporting and Market-Making Activities), 1998 NASD LEXIS 121, at *6 (Dec. 1998). Castle's supervisory system concerning OATS data transmission failed to meet this standard.

Castle's written supervisory procedures regarding OATS are inadequate. The procedures indicate that the Firm must have an OATS supervisor, but provide no detail on the method, manner or frequency of the OATS supervisor's reviews. The procedures do not identify a person who will be responsible for interfacing with the OATS Internet Website. The procedures also fail to identify a process or person responsible for reviewing the accuracy and timeliness of third parties' trade reporting conducted on behalf of the Firm. Although the Firm's supervisory procedures identified an OATS reporting manager and an OATS supervisor, they failed clearly to distinguish between the responsibilities of the two individuals and provided little detail regarding the procedures that they were expected to follow.

"Establishing, maintaining, and enforcing written supervisory procedures is a cornerstone of self-regulation within the securities industry." *NASD Notice to Members 98-96*, *supra*, 1998 NASD LEXIS 121, at *1. Castle's written procedures proved ineffective to prevent and detect the Firm's failures to submit OATS data during two lengthy periods of time. Studer himself acknowledged during testimony before the Hearing Panel that clearer and more encompassing written supervisory procedures would have assisted the Firm's employees in recognizing that the Firm's OATS password had expired during the Firm's second period of noncompliance. Based on the foregoing, we find that Castle violated NASD Rules 2110 and 3010, as alleged in cause two of the complaint.[14]

C. Castle's Failures to Accept or Decline Trades in ACT

NASD Rule 6130 requires certain ACT participants to accept or decline trades within 20 minutes of execution. Rule 6180 states that an ACT participant's failure to comply with Rule 6130 or any other ACT rule or requirement may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade and therefore a violation of Rule 2110. Castle failed to accept or reject transactions in ACT as required by the ACT rules and violated Rules 2110 and 6130.

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[14] Any violation of an NASD rule such as, in this case, Rule 3010, is also a violation of Conduct Rule 2110. *See Dep't. of Enforcement v. Shvarts*, Complaint No. CAF980029, 2000 NASD Discip. LEXIS 6, at *12 (NAC June 2, 2000).

In this case, the ACT rules affirmatively required Castle to accept or decline within 20 minutes of execution. Castle failed to accept or decline trades in ACT, within 20 minutes of execution, for 1,399 transactions between October 1, 2001, and December 31, 2001. Castle contends that it delegated its ACT acceptance responsibilities to its clearing broker. The evidence belies this assertion. Kafeiti described himself as one of Castle's on-line supervisors and testified that Castle and its clearing firm had never executed the necessary paperwork for the clearing firm to provide acceptance services to Castle. Furthermore, Castle's outside counsel stated in a March 14, 2002 letter to NASD that Castle's clearing firm had refused to provide acceptance services to Castle. Studer also stated that the individual that he had assigned to monitor the Firm's ACT compliance did not take seriously the Firm's obligation to accept or reject trades within 20 minutes. He acknowledged that the Firm should have assigned a better-qualified individual to the task.

In light of the foregoing, we find that Castle violated Rules 2110 and 6130 as alleged in cause three of the complaint.

V. Sanctions

The Hearing Panel fined Castle $25,000 for OATS violations; fined it $40,000 and imposed a 10-business-day (or until implementation of adequate supervisory procedures) suspension for supervision violations; and fined the Firm $15,000 for ACT violations. The Hearing Panel also assessed costs of $1,502.22. For the reasons discussed below, we modify the sanctions. We fine Castle $80,000, suspend the Firm for 30 business days, and impose costs.[15]

In determining sanctions, we turn first to the NASD Sanction Guidelines. The Sanction Guidelines direct adjudicators in NASD proceedings to impose progressively escalating sanctions on recidivists. In this regard, the Guidelines recommend that adjudicators consider a respondent's disciplinary history. *See* NASD Sanction Guidelines (2001 ed.) at 3 (consider past misconduct that evidences prior disregard for regulatory requirements, investor protection, or commercial integrity). In this case, the respondent has a significant disciplinary history that includes, among other matters, failures to supervise, a short sale violation, and market

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15 Castle argues that the Hearing Panel erred in imposing sanctions that exceeded the fine amount that Market Regulation suggested to settle this matter and the amounts for which NASD has settled other similar disciplinary proceedings. Castle is incorrect in this contention. NASD has long acknowledged the "broadly recognized principle that settled cases generally result in lower sanctions than fully litigated cases to provide incentives to settle." NASD Sanction Guidelines (2001 ed.) at 1; *see also DBCC v. Podesta & Co.*, Complaint No. C8A960040, 1998 NASD Discip. LEXIS 27, at *36 (NAC Mar. 23, 1998). The SEC also has emphasized that the reference to settled matters in litigated cases is inappropriate because different considerations in settling a case may result in lower sanctions in a settled matter than in a litigated matter. *See Steven D. Goodman*, 54 S.E.C. 1203, 1212 (2001) (finding that pragmatic considerations justify the acceptance of lesser sanctions in negotiating a settlement).

manipulations. In our view, Castle's disciplinary history suggests that the Firm repeatedly has faltered in its supervisory responsibilities, generally has demonstrated disregard for regulatory requirements, has posed a danger to the investing public, and previously has acted in a manner contrary to high standards of commercial honor and just and equitable principles of trade. We therefore find that Castle's disciplinary history is a significant aggravating factor with respect to sanctions in this matter.

A. OATS Violations

For Castle's OATS violations, we affirm the Hearing Panel's imposition of a $25,000 fine. In reviewing sanctions, we consider the principal considerations applicable specifically to OATS violations and the principal considerations applicable generally to all violations.[16] In this case, numerous aggravating factors exist, and Castle's OATS violations were egregious.

Castle's OATS violations occurred during two distinct and lengthy periods (nine months and two months). Castle failed, during both periods, to detect the violations and corrected them only after receiving notification from NASD. Furthermore, after resolving the Firm's first period of reporting failures, Castle failed to institute remedial procedures sufficient to prevent the second period of reporting failures. Castle also failed to accept responsibility for its misconduct, attempting to shift blame to Galaxynet, notwithstanding that it did not have a written agreement with Galaxynet and that, regardless of any agreement with Galaxynet, Castle remained primarily responsible for its own OATS reporting. Additionally, Castle's disciplinary history demonstrates that the Firm has exhibited a pattern of indifference to regulatory requirements.[17] *See Dep't. of Enforcement v. Michael F. Flannigan*, Complaint No. C8A980097, 2001 NASD Discip. LEXIS 36, at *25 (NAC June 4, 2001) (finding that, although respondents did not have a history of engaging in similar misconduct, their disciplinary histories suggested insufficient attention to regulatory compliance and could be considered in determining sanctions). Finally, we consider

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16 *See* NASD Sanction Guidelines (2001 ed.) at 9 (Principal Considerations in Determining Sanctions) and 66 (Order Audit Trail System).

17 In 2004, an SEC administrative law judge permanently enjoined Castle and Studer, ordered that they disgorge more than $130,000 for fraudulent misconduct, revoked the registration of Castle as a broker or dealer, and barred Studer from associating with any broker or dealer. *See In re Castle Sec. Corp. and Michael T. Studer*, Initial Decision Rel. No. 244, 2004 SEC LEXIS 154 (Jan. 23, 2004). The Commission affirmed the bar of Studer from associating with any broker or dealer and dismissed the proceeding with respect to Castle because Castle had withdrawn its broker-dealer registration in the interim. *See In re Michael Studer and Castle Securities Corp.*, Exchange Act Rel. No. 50411, 2004 SEC LEXIS 2135 (Sept. 20, 2004).

In January 1998, the SEC sustained our findings and the sanctions that we imposed in Complaint No. CMS940100 against Castle and Studer for stock manipulation. *See Castle Sec. Corp.*, 53 S.E.C. 406 (1998).

as an additional aggravating factor the detrimental effect that Castle's failure to report has on the regulatory audit trail.

Castle argues that its failures to report caused no harm. We disagree. "OATS provides a substantially enhanced body of information regarding orders and transactions that improves [NASD's] ability to conduct surveillance and investigations of member firms for violations of federal securities laws and [NASD] rules." Notice of Filing of Proposed Rule Change Related to Order Audit Trail System Rules, 65 Fed. Reg. 59,038, 59,039 (Sept. 26, 2000). An NASD examiner testified before the Hearing Panel that NASD's regulatory surveillance and compliance sweeps require the use of OATS information and that OATS data also is needed for timely and accurate market surveillance. Furthermore, NASD implemented OATS to fulfill one undertaking contained in the SEC's order related to an enforcement action against NASD. OATS plays a key role in NASD's regulatory efforts. Castle's OATS reporting failures therefore significantly undermined the regulatory audit trail.

In light of our finding that Castle's OATS reporting violations were egregious, we affirm the Hearing Panel's imposition of a $25,000 fine.[18]

B. Supervision Violations

With respect to Castle's supervision violations, we again find that numerous aggravating factors exist and that Castle's violations are egregious. As discussed below, we affirm the $40,000 fine imposed by the Hearing Panel and increase the suspension from 10 business days to 30 business days.

At the outset, we note that Castle's disciplinary history includes two regulatory actions for the Firm's prior failures to supervise[19] and numerous other actions that demonstrate Castle's

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[18] The fine is within the range for subsequent and egregious actions recommended in the guideline for OATS reporting failures. *See* Guidelines (2001 ed.) at 66 (Order Audit Trail System). The fine is outside the range for first actions and non-egregious cases. For the reasons discussed above, however, we find that Castle's OATS violations were egregious.

[19] On February 19, 2004, we affirmed a Hearing Panel decision in Complaint No. C3A10036 finding that Castle churned a customer account, failed reasonably to supervise trading activities in a customer's account, and induced a customer to guarantee the margin accounts of other Castle customers for no consideration. We expelled Castle. *See Dep't. of Enforcement v. Castle Sec. Corp. and Michael Studer*, Complaint No. C3A010036, 2004 NASD Discip. LEXIS 1 (NAC Feb. 19, 2004), *aff'd* Exchange Act Rel. No. 50543, 2004 SEC LEXIS 2347 (Oct. 14, 2004).

On November 14, 1994, Castle executed a Letter of Acceptance Waiver and Consent in an NASD disciplinary action (Complaint No. C10940068) involving Castle's: violations of Exchange Act Rule 15c2-6 (sales of designated securities to non-established and non-accredited

[Footnote continued on next page]

history of regulatory indifference. Castle also ignored red flags and other warnings of potential misconduct and regulatory reminders of the importance of OATS reporting. Castle's failures with respect to OATS supervision enabled the Firm to fall into noncompliance for two distinct periods. Castle failed to rectify its supervisory and OATS reporting deficiencies after its first 191-business-day period of noncompliance and remarkably allowed a second period of noncompliance to last for an additional 35 business days. During this period, NASD published numerous Notices to Members and other Web-based advisories to impress upon member firms the importance of compliance with OATS reporting.

We also find aggravating the fact that Castle's failure to implement sufficient supervisory procedures resulted in significant underlying OATS violations that compromised the regulatory audit trail. The Firm's recidivist activities with respect to supervisory violations, its unwillingness to ensure accurate OATS reporting, and its indifference to implementing appropriate supervisory practices[20] suggest that a significant sanction is necessary in order to deter Castle and others similarly situated from engaging in similar misconduct. For Castle's supervisory violations, we therefore fine the Firm $40,000 and suspend it for 30 business days, or until Castle implements and NASD's Department of Market Regulation approves Castle's amended supervisory procedures.[21]

C. ACT Violations

As to Castle's ACT violations, we affirm the Hearing Panel's imposition of a $15,000 fine. We also find Castle's ACT violations to be egregious and have considered numerous aggravating factors in determining sanctions.

Castle failed to accept or decline within 20 minutes of execution 1,399 transactions during a three-month period. The NASD Sanction Guidelines indicate in the General Principles Applicable to All Sanction Determinations that, although aggregation of violations may be appropriate for purposes of determining sanctions in certain instances, multiple violations also

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public customers); distribution of misleading sales literature to customers; and failure to supervise associated persons with respect to compliance with Exchange Act Rule 15c2-6.

[20] Studer indicated during the Hearing Panel hearing that, as of the date of the hearing, the Firm still had not assigned a person to monitor the Firm's OATS reporting compliance via the OATS Internet Website or to review other OATS information. Indeed, Castle's supervisory procedures identified Studer as the Firm's OATS supervisor, but Studer testified at the Hearing Panel hearing that he had never learned to navigate the OATS Internet Website.

[21] These sanctions are within the range indicated for egregious failures to supervise in the applicable guideline. *See* NASD Sanction Guidelines (2001 ed.) at 108 (Supervision – Failure to Supervise). We find that Castle's supervision violations are egregious. This is Castle's third supervision violation and, as discussed above, numerous aggravating factors exist.

may be treated individually such that a sanction is imposed for each violation. *See* NASD Sanction Guidelines (2001 ed.) at 6 (Order Audit Trail System). The Sanction Guidelines also indicate that numerous, similar violations may warrant higher sanctions and that the existence of multiple violations may be treated as an aggravating factor. Given the extensive number of Castle's ACT violations and the regulatory importance of timely acceptance or rejection of trades,[22] we have determined to treat Castle's ACT violations, for purposes of sanctions, as multiple violations rather than one batched violation.[23]

Castle also failed to accept responsibility for its ACT violations and attempted to no avail to shift blame and responsibility for ACT acceptance to its clearing firm. The evidence indicated that Castle's clearing firm had never agreed to perform acceptance services for Castle. Furthermore, Castle also attempted to shift blame for its noncompliance to staff turnover and to inadequate staff training, neither of which excuses the Firm's misconduct. Indeed, NASD Compliance Report Cards for periods subsequent to the period at issue in this complaint indicate that Castle continued to demonstrate difficulties with timely ACT reporting, thereby suggesting that Castle has not employed subsequent corrective measures.

In light of the foregoing, we find that significant sanctions are in order. We fine Castle $15,000.[24]

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[22] Castle claims that its misconduct did not damage the regulatory audit trail and therefore caused no harm. We do not agree that Castle's conduct caused no harm. In Notice to Members 89-76, NASD stated to its membership that ACT provides the following regulatory benefits: same-day comparison and locked-in clearing for all Nasdaq trades; less exposure to price movements for open items; on-line access to the status of each trade report; faster, more efficient trade reconciliation and confirmation; and increased efficiency of back-office operations. *NASD Notice to Members 89-76* (Mandatory Participation by Self-Clearing Firms in the Automated Confirmation Transaction Service Set for First Quarter 1990), 1989 NASD LEXIS 91, at *4 (Dec. 1989). Additionally, ACT helps member firms to trade within their capital limits by locking in trades in a timely and efficient manner. Castle's repeated ACT violations potentially placed its clearing firm at risk because Castle could have traded beyond its capital limits without detection. The regulatory importance of ACT underscores the potential risk to the marketplace and to clearing firms that could be caused by a failure to comply.

[23] The applicable guideline recommends a fine of $1,000 to $2,000 for a first action; a fine of $2,000 to $10,000 for a second action; and a fine of $5,000 to $100,000 for subsequent actions. Given the number and severity of Castle's ACT violations, we have determined to impose a fine that falls within the range recommended for subsequent actions.

[24] As discussed in note 23, *supra*, the fine is outside the range recommended for first actions. Given the number of Castle's ACT violations and the egregiousness of the violations, however, we find it appropriate to treat each of Castle's multiple ACT reporting failures as an individual violation and to impose a sanction in the range recommended in the guideline for "subsequent actions." *See* Guidelines (2001 ed.) at 72 (Trade Reporting – Late Reporting; Failing to Report; False, Inaccurate, or Misleading Reporting).

D. Alleged Inability to Pay

Castle alleges that it does not have sufficient financial resources to pay the fine imposed by the Hearing Panel and that, given its size, the NAC should reduce the sanctions. We reject this argument and find that Castle has not demonstrated a *bona fide* inability to pay.

A respondent who raises inability to pay carries the burden of producing evidence sufficient to support the claim and to prove *bona fide* insolvency. *DBCC v. Schiff*, Complaint No. C10970156, 1999 NASD Discip. LEXIS 15, at *22 (NAC Apr. 9, 1999) (finding that evidence of respondent's negligible net worth and income is not sufficient to prove *bona fide* insolvency); *Toney L. Reed*, 52 S.E.C. 944, 947 (1996) (holding that respondent has the burden of introducing evidence sufficient to prove *bona fide* insolvency). Furthermore, proof of *bona fide* insolvency requires that the accuracy of all financial information be verified "through the submission of signed and notarized documents evidencing financial hardship." *Dep't. of Enforcement v. Levitov*, Complaint No. CAF970011, 2000 NASD Discip. LEXIS 12, at *33-34 (NAC June 28, 2000).

In support of Castle's inability to pay argument, Castle offered unaudited balance sheets and an income tax return for the year ending September 30, 2002. Subsequent to the Hearing Panel hearing, Castle submitted a post-hearing written submission in which it argued that the Firm's financial condition had further deteriorated and to which it appended a draft FOCUS Part IIA report for the period ended June 30, 2003. Castle's unaudited and unsigned records, none of which are notarized, do not constitute reliable information regarding Castle's true financial condition. *See Levitov, supra*.

Furthermore, even if Castle's financial documentation were reliable, which we do not find it is, the documentation is not sufficient to prove Castle's *bona fide* insolvency. "The fact that [the respondent] may have limited funds in a particular bank account does not indicate that [the respondent] is 'insolvent' and does not prove that [the respondent] is without funds or assets from other sources." *DBCC v. Gerald Cash McNeil,* Complaint No. C3B960026, 1999 NASD Discip. LEXIS 3, at *26 (NAC Jan. 21, 1999). Castle's balance sheet dated April 30, 2003, shows total assets of $59,442, including more than $45,000 on deposit with two clearing firms and $71,957 in receivables that Castle has elected to write off as uncollectible. Castle's September 30, 2002 tax return reports a decline in the Firm's assets from $460,044 to $92,568. Castle has not offered an explanation for this significant decline. The tax return also indicates, however, the following information regarding Castle's expenditures during that period of time: $98,700 for "consulting" services; $41,179 for "legal and accounting" fees; $8,778 for "auto expenses"; and $2,624 for "meals/entertainment." Castle's draft FOCUS report for June 2003 reported total assets of $69,707 and excess net capital of $12,046. Castle's financial documents do not reliably demonstrate *bona fide* insolvency.[25]

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[25] Castle argues that the amount of the fine should be somehow limited by the amount of the Firm's net capital. We do not agree. A respondent claiming inability to pay must demonstrate insolvency, and the amount of a fine against a firm need not be related to or limited by the

[Footnote continued on next page]

Castle also argues that, in imposing sanctions, we must consider the size of Castle and that it is not a large firm. Indeed, the NASD Sanction Guidelines direct adjudicators to consider firm size in determining sanctions. The Guidelines also state that the factors to be considered in connection with firm size include "other entities that the firm controls, is controlled by, or is under common control with." NASD Sanction Guidelines (2001 ed.) at 3. Castle is owned entirely by Castle Holdings, yet Castle has not introduced reliable evidence regarding Castle Holdings' ability or willingness to infuse additional capital into Castle or Castle's efforts to borrow such funds from Castle Holdings or other Castle Holdings subsidiaries.[26] In this matter, Castle's claims regarding firm size do not support a reduction of sanctions, particularly in light of the dearth of evidence of Castle's inability to pay.

* * * * *

In light of the foregoing considerations, we impose the following sanctions: we fine Castle $80,000 ($25,000 for OATS violations, $40,000 for supervisory violations, and $15,000 for ACT violations); suspend the Firm in all capacities for 30 business days or until the Firm develops and implements an adequate supervisory system that NASD's Department of Market Regulation has approved; and impose hearing costs of $1,502.22 plus appeal costs of $1,441.34.

VI. Conclusion

We find that Castle violated: (1) Rules 2110 and 6955 by failing to submit required OATS information for 191 consecutive business days and an additional period of 35 consecutive business days, as alleged in cause one; (2) Rules 2110 and 3010 by failing to establish, enforce, and maintain an adequate supervisory system concerning OATS submissions, as alleged in cause two; and (3) Rules 2110 and 6130 by failing to accept or decline in ACT 1,399 transactions within 20 minutes of execution, as alleged in cause three.[27] Accordingly, we fine Castle

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[cont'd]
amount of a member firm's required net capital. *See Flannigan*, *supra*, 2001 NASD Discip. LEXIS 36, at *24 (holding that the fine against a member firm need not be related to or limited by the firm's required net capital); *DBCC v. Podesta & Co.*, Complaint No. C8A960040, 1998 NASD Discip. LEXIS 27, at *37 n. 27 (NAC Mar. 23, 1998) (holding that adjudicator need not consider potential impact of fine on firm's net capital).

[26] Castle entered into evidence before the Hearing Panel Castle Holdings' Form 10-QSB for the quarter ended June 30, 2002, which reported a $50,000 reserve for SEC and NASD matters pending against Castle. Castle contended in its post-hearing brief, however, that Castle Holdings currently has less than $1,000 in assets, significant outstanding liabilities, and a financial inability to bolster Castle's financial position. Castle has not supported this claim with reliable documentary evidence and therefore has not substantiated its accuracy.

[27] We also have considered and reject without discussion all other arguments advanced by the Firm.

[Footnote continued on next page]

$80,000; suspend the Firm in all capacities for 30 business days or until the Firm develops and implements an adequate supervisory system that NASD's Department of Market Regulation has approved; and assess total costs of $2,943.56.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President
and Corporate Secretary

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Pursuant to NASD Procedural Rule 8320, any member that fails to pay any fine, costs, or other monetary sanction imposed in this decision, after seven days' notice in writing, will summarily be suspended or expelled from membership for non-payment. Similarly, the registration of any person associated with a member who fails to pay any fine, costs, or other monetary sanction, after seven days' notice in writing, will summarily be revoked for non-payment.