BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

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 Decision No. SD06012 Date: 2006

I. Introduction

On November 14, 2005, the Sponsoring Firm[1] ("the Firm") submitted a Membership Continuance Application ("MC-400" or "the Application") with NASD's Department of Registration and Disclosure ("Registration and Disclosure"), seeking to permit X, a person subject to a statutory disqualification, to "continue to associate" with the Firm as a general securities representative.[2] In April 2006, a subcommittee ("Hearing Panel") of NASD's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing,

[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] A person who becomes statutorily disqualified while he or she is employed in the securities industry is permitted to remain in the industry until the MC-400 application process has been completed. The Sponsoring Firm initially filed the Application in November 2005, requesting permission from NASD for X to "continue to be employed" as a general securities representative because she had been associated in that capacity with the Firm since May 2005. The Sponsoring Firm asserted that when it filed the Application, it believed that X had not become statutorily disqualified until September 2005, when she was sentenced for her felony. Therefore, NASD's Department of Member Regulation ("Member Regulation") at first permitted X to continue working with the Sponsoring Firm while her Application was pending. Subsequently, Member Regulation withdrew its earlier approval of X's registration, and the Firm terminated her in March 2006 (the circumstances surrounding this withdrawal of registration are outlined in further detail below). Accordingly, the Sponsoring Firm's Application was restyled as a request for X to "become associated" with the Sponsoring Firm.

accompanied by her counsel and her Proposed Supervisor. LL and JK appeared on behalf of Member Regulation.

For the reasons explained below, we deny the Sponsoring Firm's Application.[3]

II. The Statutorily Disqualifying Event

X is statutorily disqualified because she pled guilty in April 2005, to driving while intoxicated ("DWI"), a felony in the state of New York.[4] In September 2005, a New York state court sentenced X to five years' probation, revoked her driver's license for one year, and fined her $2,000. On that same date, the New York State judge granted X a Certificate of Relief from Disabilities.[5] X's probation is due to expire in September 2010.

III. Background Information

A. X

1) Registration History

X first registered in the securities industry as a general securities representative (Series 7) in October 1983. She also passed the uniform securities agent state law examination (Series 63) in October 1983.

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[3] Pursuant to NASD Procedural Rule 9524(a)(10), the Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. In turn, the Statutory Disqualification Committee considered the Hearing Panel's recommendation and presented a written recommendation to the National Adjudicatory Council, in accordance with Procedural Rule 9524(b)(1).

[4] X's 2005 conviction is a felony because she had two prior DWI misdemeanor convictions in New York. The first, in June 1997, resulted in a $750 fine. The second, in January 1999, resulted in a $500 fine, a six-month revocation of her driver's license, and a three-year probation. X successfully completed her probation for the 1999 misdemeanor DWI conviction and regained her driver's license.

[5] The Securities and Exchange Commission has stated that such a certificate, while restoring certain rights and responsibilities of citizenship, does not remove a person from statutory disqualification. Instead, the Commission has held that a certificate is a "factor to be considered" in a statutory disqualification proceeding. *Jonathan Scott Saluk*, Exchange Act Rel. No. 35623, 1995 SEC LEXIS 923, at *2 (Apr. 19, 1995). X's counsel acknowledged at the hearing that X's certificate does not excuse her statutory disqualification and that X must fully disclose the felony charge and conviction.

X was previously employed by Firm One from October 1983 until November 1997, and Firm Two from November 1997 until April 2005.

Firm Two discharged X in April 2005, stating on the Uniform Termination Notice for Securities Registration ("Form U5") that she "violated firm policy by accepting from a customer oral discretion to place certain trades in his account."[6]

2) Failure to Disclose Felony Conviction to the Sponsoring Firm

X became associated as a general securities representative with the Sponsoring Firm in May 2005. During its initial consideration of this Application in early 2006, Member Regulation discovered that X had failed to disclose her April 2005 guilty plea and felony conviction when she filed her initial Uniform Application for Securities Industry Registration or Transfer ("Form U4") with the Sponsoring Firm in May 2005. X contested Member Regulation's assertion.[7] Member Regulation consulted with NASD's Department of Registration and Disclosure on this issue, and, in March 2006, Member Regulation advised the Firm that NASD was withdrawing its earlier approval of X's registration due to her failure to disclose her April 2005 guilty plea on the May 2005 Form U4 submitted to the Sponsoring Firm. The Firm terminated X in March 2006, and filed a Form U5 in March 2006.

3) Investigations and Complaints Involving X

In January 2006, Firm Two submitted to NASD an amended Form U5 that stated that the New York Stock Exchange ("NYSE") had begun an investigation of alleged unauthorized activity by X in two customers' accounts when she was employed at Firm Two. Because this investigation remains pending, Member Regulation was not able to obtain any further information on this allegation. Following the hearing, in response to the Hearing Panel's request for information on this issue, X provided copies of: 1) a letter X wrote to the NYSE dated July 2005; 2) a letter from the NYSE to X dated January 2006; and 3) a letter dated January 2006 to the NYSE from X. These letters indicate that in May 2005, the NYSE informed X that it was conducting an investigation following Firm Two's April 2005 termination of her employment and requested a statement from X regarding alleged unauthorized activity in the account of Customer One. X responded to the NYSE's request in July 2005, denying that she had effected

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[6] At the hearing, X disputed the statement on the Form U5, testified that she did not exercise oral discretion, and maintained that Firm Two had terminated her because it wanted to eliminate her and save money by distributing her clients and income between the remaining two members of her partnership "team."

[7] X maintained that, in May 2005, she answered "Yes" to question 14A(1)(b) on the Form U4 as to whether she had been "charged" with a felony, but answered "No" to question 14A(1)(a) as to whether she had been "convicted" of a felony. In an affidavit dated March 2006, X stated that she believed at that time that the 2005 felony DWI charge became final and a "conviction" only when she was sentenced in September 2005.

any transactions in Customer One's account without prior approval. Thereafter, the NYSE notified X by letter dated January 2006, that it had begun an investigation into allegations of unauthorized activity by X in the accounts of Customers One and Two. The NYSE stated that "[t]he investigation is not a reportable event at this time." X responded in a letter dated January 2006, that she had nothing further to add to her July 2005 statement regarding Customer One, and that she had not effected any trades on behalf of Customer Two without "verbal authorization over the phone or in the office."

NASD's Central Registration Depository ("CRD"®) reflects that four customer complaints have been filed against X. The first complaint, received in 1996, alleged that X made two unauthorized sales of stock and engaged in churning while she was associated with Firm One. In May 1997, Firm One settled the complaint for $2,042. X did not contribute individually to the settlement.

The second complaint, received in October 1998, alleged that X engaged in misrepresentations while she was associated with Firm One. In November 1998, Firm One settled the complaint for $3,000. X did not contribute individually to the settlement.

The third complaint, received in December 2000, alleged that X made unsuitable recommendations when she was associated with Firm Two. In January 2001, Firm Two and X denied this complaint, and there is no record of any further action taken by the customer.

The fourth complaint, received in March 2001, alleged that X made unsuitable recommendations and failed to follow client instructions while she was with Firm Two. This complaint went to NASD arbitration, and the claimant sought compensatory damages of $200,000. CRD indicates that records related to this matter were "lost on September 11, 2001." In April 2002, the arbitration panel awarded the claimant compensatory damages of $175,000. X did not contribute individually to the award.

The record shows no additional complaints, regulatory proceedings, or disciplinary actions against X.

B. The Firm

The Sponsoring Firm became an NASD member in March 1992. The Firm is based in City 1, State 1 and has one branch office and one office of supervisory jurisdiction ("OSJ") that is also the Firm's home office. The Sponsoring Firm's MC-400 states that it employs 48 employees, of whom 10 are registered principals, and 35 are registered representatives. The Firm is a full-service broker-dealer.

NASD has begun, but has not yet completed, its 2004 and 2006 routine examinations of the Firm. NASD issued the Firm Letters of Caution ("LOCs") for the 2000 and 2002 routine examinations.

In the 2000 LOC, NASD cited the Firm for books and records violations, one continuing education violation, and failure to fully report certain state and court actions against one former

registered representative. The Firm responded by letter dated January 2001, stating the measures that it had taken to correct the cited problems.

In the 2002 LOC, NASD cited the Firm for failing to establish a system to monitor and prevent outbound solicitation calls; failing to address certain business practices in its written supervisory procedures; failing to maintain a readily available and centralized "Do-Not-Call List;" failing to accurately compute net capital for the period ending June 2002; and filing an inaccurate FOCUS report due to the incorrect June 2002 net capital computation. The Firm responded by letter dated March 2003, stating the measures that it had taken to correct the deficiencies noted by NASD.

The record shows no other customer complaints, regulatory proceedings, or arbitrations against the Firm.

IV. X's Proposed Business Activities and Supervision

The Firm proposes to employ X as a general securities representative in its home office in City 1, State 1. The Sponsoring Firm will compensate X by a percentage of commissions and sales charges.

The Firm proposes that the Proposed Supervisor will be X's primary, responsible supervisor. The Proposed Supervisor has been associated with the Sponsoring Firm since August 1996 and is the branch manager at the Firm's home office. The Proposed Supervisor currently supervises 11 registered representatives at that location. He has been employed in the securities industry as a general securities representative (Series 7) since February 1988. He qualified as a uniform securities agent (Series 63) in March 1988, and a general securities principal (Series 24) in February 1998.[8]

The Proposed Supervisor has been the subject of six customer complaints.[9] The first customer submitted a complaint in October 1990 for an unauthorized transaction and withdrew it shortly thereafter with no action having been taken.

The second customer initiated a complaint in April 1993, alleging that the Proposed Supervisor had engaged in unauthorized, unsuitable, and excessive trading. The alleged

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[8] The Proposed Supervisor was previously associated with Firm A from February 1988 until April 1990 and Firm B from April 1990 until August 1996.

[9] At the hearing, the Proposed Supervisor testified that the six complaints stemmed from his employment with Firm B. According to the Proposed Supervisor, during the 1990s, Firm B was engaged in massive litigation regarding sales of limited partnerships. The Proposed Supervisor stated that Firm B's media exposure from the settlement of such suits led other customers to file complaints against Firm B representatives for various alleged infractions. The Proposed Supervisor denied culpability as to each customer complaint.

compensatory damages were $75,000. Firm B settled the complaint in December 1994 for $12,000. The Proposed Supervisor did not contribute individually to the settlement.

The third customer filed a complaint against the Proposed Supervisor in November 1993, alleging misrepresentation, unsuitable transactions, and unauthorized trades. The alleged compensatory damages were $150,000. Firm B settled the complaint in July 1994 for $57,000. The Proposed Supervisor did not contribute individually to the settlement.

The fourth customer submitted a complaint against the Proposed Supervisor in November 1994, alleging unsuitable transactions and churning. The alleged compensatory damages were $40,000. Firm B settled the complaint for $4,000 in May 1995. In addition, CRD indicates that the Proposed Supervisor settled with the customer for $15,000. At the hearing, the Proposed Supervisor testified that the CRD information regarding his contribution is incorrect and that he had not contributed to this settlement.

The fifth customer initiated a complaint against the Proposed Supervisor in January 1995, alleging unauthorized transactions, churning, unsuitable transactions, and failure to follow customer directions. The customer requested $110,000 in compensatory damages. Firm B settled the complaint for $15,000 in July 1995, and the Proposed Supervisor was dismissed from the case with no liability.

The sixth customer filed a complaint in August 1997, alleging unauthorized trading, churning, excessive margin, and over-concentration, and requesting $150,000 in compensatory damages. Firm B settled the complaint for $20,000 in September 1998, at which time the Proposed Supervisor was dismissed from the case.

The record does not contain any other disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because X's felony conviction is recent, she will remain on probation until 2010, she failed to disclose her 2005 felony conviction to the Firm, and she was dismissed from Firm Two in April 2005 for violating firm policy. In making its recommendation, Member Regulation noted the Firm's lack of formal disciplinary history and the Proposed Supervisor's history of old customer complaints. Member Regulation stated, however, that its concerns with X's background outweighed the Firm's relatively clean record and the Proposed Supervisor's history of old customer complaints.

VI. Discussion

After carefully reviewing the entire record in this matter, including the post-hearing briefs filed by the parties, we deny the Firm's Application to employ X as a general securities representative.

In reviewing this type of application, we have considered whether the particular felony at issue, examined in light of the circumstances related to the felony, and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.[10] We assess the totality of the circumstances in reaching a judgment about X's future ability to deal with the public in a manner that comports with NASD's requirements for high standards of commercial honor and just and equitable principles of trade in the conduct of her business.

For the reasons set forth below, we conclude that X's participation in the securities industry will present an unreasonable risk of harm to the market or investors.

A. X's Criminal Convictions and Regulatory History

X was convicted of a recent, serious criminal offense. Moreover, she is a repeat offender, having had three DWI convictions between June 1997 and April 2005. X will remain on probation for her 2005 felony DWI conviction until September 2010. We acknowledge that X testified that she has been involved with Alcoholics Anonymous and has undergone counseling since her last DWI arrest, and that she has thus far complied with the terms of her probation. Yet we note that X has recognized and treated her chronic alcohol problem only during the last year, and we therefore share Member Regulation's concern that sufficient time has not yet elapsed for X to demonstrate that the change in her behavior pattern is fundamental and longlasting and that she can conduct herself in a responsible and compliant fashion in the securities industry.

Moreover, our concern with X's pattern of criminal convictions is buttressed by other evidence in the record suggesting that she may be unable to conform her behavior to applicable laws and regulations. Firm Two terminated X in April 2005, stating on the Form U5 that she "violated firm policy by accepting from a customer oral discretion to place certain trades in his account." This matter is currently being investigated by the NYSE. Additionally, four customers filed complaints against X between 1996 and 2001, and three of those complaints resulted in monetary awards to the claimants. Although certain of these matters have not been adjudicated, they cause us to question whether there have been recent instances when X may have failed to act in the best interest of her customers.

B. X's Failure to Disclose the 2004 Felony DWI Charge and 2005 Conviction

There is no dispute that X was convicted of a felony DWI in 2005 that resulted in her being statutorily disqualified.[11] The question is when that conviction occurred and what effect

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[10] *See Frank Kufrovich*, Exchange Act Rel. No. 45437, 2002 SEC LEXIS 357, at *16 (Feb. 13, 2002) (upholding NASD's denial of a statutory disqualification applicant who had committed non-securities related felonies "based upon the totality of the circumstances" and NASD's explanation of the bases for its conclusion that the applicant would present an unreasonable risk of harm to the market or investors).

[11] *See* Art. III, Sec. 4 (g)(1) of NASD's By-Laws:

[Footnote continued on next page]

that should have on our consideration of the Application. Member Regulation asserts that X was convicted of the felony DWI when she entered a guilty plea to the felony charge in April 2005, and therefore she improperly completed the Form U4 with the Sponsoring Firm in May 2005.[12] X argues that when she submitted her Form U4 to the Sponsoring Firm in May 2005, she did not believe that her guilty plea was "final" and did not understand that she was "convicted" until she was sentenced for the felony in September 2005, at which time she informed the Sponsoring Firm and the Firm amended her Form U4. We find that X was convicted of the felony charge in April 2005.

The term "convicted" is not defined in either the Securities Exchange Act of 1934 ("the Exchange Act") or NASD's By-Laws. The Commission has advised NASD to look first to federal securities laws for guidance on this issue and instructed NASD to turn to Section 2(a)(10) of the Investment Company Act of 1940 and Section 202(a)(6) of the Investment Advisers Act of 1940, which define "convicted" to include: "a verdict, judgment or plea of guilty, or a finding of guilt on a plea of nolo contendere, if such verdict, judgment, plea or finding has not been reversed, set aside, or withdrawn, whether or not sentence has been imposed." Interpretative letter dated February 1992, from JF, Assistant Director, Division of Market Regulation, SEC, to BL, Associate General Counsel, NYSE. Commission staff have concluded that "[w]hen a court accepts a plea of guilty . . . [the] conviction remains in effect until reversed, set aside or withdrawn irrespective of whether a sentence has been imposed." *Id*. at 2.

The Commission has also stated that a state's interpretation of its laws may provide guidance concerning the question of when a defendant has been convicted of a felony. *Id*. at 4. The parties agree that in December 2004, X was arrested and charged with felony DWI. The record also shows that in April 2005, X entered a guilty plea to the felony DWI. New York Consolidated Law Service, Criminal Procedure Law, section 1.20(13) defines "conviction" as "the entry of a plea of guilty." This provision became effective on September 1, 1971, and drafters of the revised New York Criminal Procedure Law explained that their purpose in

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> A person is subject to a 'disqualification' with respect to membership, or association with a member, if such person:
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> (g)(1) has been convicted within ten years preceding the filing of any application . . . to become associated with a member of the NASD . . . of any felony.

[12] As we stated previously, in March 2006, Member Regulation cited X's failure to disclose her April 2005 guilty plea on her May 2005 Form U4 with the Sponsoring Firm as the reason for its withdrawal of approval of X's registration with the Firm. Member Regulation's action in withdrawing its approval of X's registration with the Sponsoring Firm is not under review here.

redefining the term "conviction" was to clarify a previously uncertain meaning and "accord formal recognition to the word 'conviction' as a verdict or plea of guilty (without a sentence)." *See* N.Y. Crim. Proc. Law Sec. 1.20 staff notes (consd.).

X's argument that she had been advised by her then attorney that she was not "convicted" in April 2005 because her guilty plea remained conditional and subject to withdrawal or a motion to vacate is unavailing in this action.[13] Under New York law, a defendant who seeks to withdraw a "guilty" plea or change a "guilty" plea to a "not guilty" plea may do so only at the discretion of the court. N.Y. Crim. Proc. Law Sec. 220.60 (1), (2), and (3). The guilty plea nonetheless constitutes a conviction from the time it is entered, until the court has agreed to withdraw or vacate the plea. *See New York v. D'Amico*, 556 N.Y.S. 2d 456, 458 (Sup. Ct. 1990), *appeal denied*, 594 N.E.2d 947 (N.Y. 1992); *see also New York v. Alexander*, 769 N.E.2d 802, 804 (N.Y. 2002). We therefore conclude that X was convicted in April 2005.[14]

Moreover, setting aside the issue of whether X properly disclosed her April 2005 *conviction*, we find that the record shows that X failed to make adequate disclosure of her December 2004 arrest and charge of felony DWI. X argues that because she was unaware at the time that the guilty plea was considered to be a conviction, she therefore answered "yes" to question 14A(1)(b) on the Form U4 as to whether she had been "charged" with a felony, but answered "no" to question 14A(1)(a) as to whether she had been "convicted" of a felony. On the criminal disclosure reporting page ("DRP") accompanying the May 2005 Form U4, however, X made no mention of the December 2004 felony DWI arrest. Instead, she described only a previous 1997 felony DWI charge that resulted in a conviction for a misdemeanor.[15] Because

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[13] At the hearing, Member Regulation stated that, thus far, it had not referred X's Form U4 responses to NASD's Department of Enforcement for disciplinary action. Accordingly, there has not yet been a disciplinary action to determine whether X committed a "willful" or a "non-willful" failure to disclose, and we do not reach that issue in this statutory disqualification proceeding. The distinction between a willful and non-willful failure to disclose is critical because a finding of willful failure to disclose results in a separate, lifetime statutory disqualification under the Exchange Act and NASD's By-Laws. *See* Secs. 15(b)(4) and 3(a)(30) of the Exchange Act and Art. III, Sec. 4(f) of NASD's By-Laws. In this statutory disqualification proceeding, we look to the circumstances surrounding X's failure to disclose as one of the factors in the totality of circumstances that we consider in determining whether she should re-enter the securities industry despite her statutorily disqualifying 2005 felony conviction.

[14] Our conclusion is bolstered by a Certificate of Disposition issued in October 2005, by the New York state court that processed X's felony criminal matter, stating that "[in April 2005], [X] was convicted of . . . a class 'D' Felony . . . in satisfaction of this Superior Court Information."

[15] X incorrectly stated at the hearing that she had marked the 2004 felony arrest and charge as "pending" on her initial Form U4 with the Sponsoring Firm in May 2005. To the contrary, the record shows that the felony DWI was not listed as "pending," or described in an accompanying

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the Form U4 failed to mention the December 2004 felony DWI arrest, the Sponsoring Firm was therefore unable to ascertain the necessary information regarding X's criminal background to enable it to make an informed decision on her employment. X's lack of candor and forthrightness in her responses on the Form U4 are an important factor for us to consider in determining whether the public interest would be served by allowing her to be employed in the securities industry. The Commission has described the Form U4 as a "vital screening device" that is relied on by "all the self-regulatory organizations, including the NASD, state regulators, and broker-dealers to monitor and determine the fitness of securities professionals." *Rosario R. Ruggiero*, 52 S.E.C. 725, 728 (1996) (stating that "[t]he candor and forthrightness of [individuals making these filings] is critical to the effectiveness of this screening process"); *see also Daniel Richard Howard*, Exchange Act Rel. No. 46269, 2002 SEC LEXIS 1909, at *9-10 (July 26, 2002).

The record further demonstrates that X was no more forthcoming in her personal interview with the Firm than she was on the Form U4 and accompanying DRP. Although X stated at the hearing that she "thought [she] mentioned" her December 2004 felony DWI arrest to the Proposed Supervisor during her interview, the Proposed Supervisor testified that he was not aware of X's 2004 felony DWI arrest until Registration and Disclosure contacted him in late May 2005 and informed him of the FBI report it had received in response to X's fingerprint submission. Moreover, in response to a question from the Hearing Panel, the Proposed Supervisor testified that he "does not know" if he would have acted differently in hiring X if he had been aware in May 2005 that she had a felony DWI charge and conviction.

We thus conclude that X's failure to properly inform the Sponsoring Firm of her criminal charges and convictions leads us to question her integrity and her ability to observe the high standards of commercial honor and just and equitable principles of trade required for participants in the securities industry.

C. The Firm, the Supervisor, and the Proposed Supervision

In assessing the merits of this Application, we note that the Sponsoring Firm has no formal disciplinary history. The Proposed Supervisor, however, has been the subject of several customer complaints relating to his trade practices. We recognize that these complaints are not recent – the first complaint was received more than 15 years ago, and the most recent complaint was received almost eight years ago. We note, however, that the Proposed Supervisor's discussion of those complaints at the hearing was not entirely satisfactory as he tended to minimize the complaints, blame Firm B, and avoid accepting responsibility for any of the problems. Supervision of a statutorily disqualified person requires heightened procedures and extra dedication on the part of a manager. We are not convinced that the Proposed Supervisor

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DRP, until the Firm filed an amended Form U4 in August 2005 in response to an inquiry from Registration and Disclosure.

could effectively supervise X and continue to represent his many clients and supervise numerous other representatives.

VII. Conclusion

Accordingly, we find that it is not in the public interest, and would create an unreasonable risk of harm to the market or investors, for X to become associated with the Sponsoring Firm as a general securities representative. We therefore deny the Application.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President and Corporate Secretary