

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Continued Association of	Redacted Decision
X	<u>Notice Pursuant to</u>
as a	<u>Rule 19h-1</u>
General Securities Principal	<u>Securities Exchange Act</u>
with	<u>of 1934</u>
The Sponsoring Firm	<u>Decision No. SD06003</u>
	Date: 2006

I. Introduction

On July 6, 2005, the Sponsoring Firm¹ (“the Firm”) filed a Membership Continuance Application (“MC-400” or “the Application”), seeking to permit X, a person subject to a statutory disqualification, to continue to associate with the Firm as a general securities principal. X has been associated with the Firm as a general securities representative since February 2004. In December 2005, a subcommittee (“Hearing Panel”) of NASD’s Statutory Disqualification Committee held a hearing on the matter. X appeared in person at the hearing, pro se, accompanied by Employee 1, the Firm’s Manager of Information Systems. X’s Proposed Supervisor appeared by telephone. LL and GW appeared on behalf of NASD’s Department of Member Regulation (“Member Regulation”).

For the reasons explained below, we approve the Sponsoring Firm’s Application.

II. The Statutorily Disqualifying Event

X is statutorily disqualified because in April 1988, NASD accepted a settlement in a disciplinary action against him. NASD censured X, fined him \$2,000, and barred him in any principal capacity for allowing an individual to engage in the securities business without being properly registered, and for failing to supervise that individual who engaged in unauthorized transactions and excessive trading of customers’ accounts.

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.

III. Background Information

A. X

X first registered in the securities industry in June 1983 as a general securities representative (Series 7). He qualified as an equity trader (Series 55) in April 1999, initially qualified as a general securities principal (Series 24) in August 1984, and requalified as a general securities principal in June 2005. He associated with the Sponsoring Firm as a general securities representative in February 2004.² The Firm represents that X's current job functions include making markets in equity securities, executing proprietary orders, executing institutional retail orders, and executing orders appearing on the Order Management System through Bloomberg.

X has no other regulatory or criminal history.

B. The Firm

The Sponsoring Firm became an NASD member in December 1984. Its home office is in City 1, State 1, and it has one office of supervisory jurisdiction ("OSJ") and no branch offices. It employs 11 registered principals and 20 registered representatives. The Firm is a full service broker-dealer that makes markets in debt and equity securities and engages in investment banking and institutional sales. It has also been a member of the Pacific Stock Exchange since March 2004.

The Firm's last two routine examinations in 2000 and 2002 resulted in the issuance of Letters of Caution ("LOC"). The 2000 LOC cited the Firm for reporting violations. The 2002 LOC cited the Firm for filing inaccurate statistical and quarterly summary information regarding customer complaints.

The Firm also consented to two Letters of Acceptance, Waiver, and Consent ("AWC") from prior routine examinations in 1996 and 1998. The 1996 AWC cited the Firm for unfair and excessive mark-ups on foreign corporate bonds and imposed a censure, a \$5,000 fine, and \$24,167.33 in restitution. The 1998 AWC cited the Firm for improper trade reporting and imposed a \$5,000 fine.

NASD has commenced, but not yet completed, its 2004 routine examination of the Firm.

² He was previously associated with Firm One from September 1983 until 1986; Firm Two from June 1986 until August 1996; Firm Three from August 1996 until June 2001; and Firm Four from August 2001 until October 2002 and again from November 2003 until February 2004.

The record does not show any additional complaints, disciplinary proceedings, or arbitrations against the Firm.

IV. X's Proposed Business Activities and Supervision

The Firm proposes to continue to employ X as a general securities principal, as well as a general securities representative. He will work from his home office in City 2, State 1³ and serve as a backup to the Firm's head trader, the Proposed Supervisor, who works in the Firm's headquarters in City 1, State 1. The Firm states, however, that X will not have any supervisory duties over personnel. Rather, the Firm represents that X's job functions will remain the same as they have been since he began working in February 2004 as a general securities representative with the Sponsoring Firm in its City 1 office – but now he will be performing them from a remote location. The Firm states that it must associate X as a general securities principal to comply with NASD rules.⁴

The Firm represents that customers will not visit X's home office, and that it will not be publicly identified as a branch office; will not appear in telephone directories, on letterhead, or business cards; and will be used only as a backup facility in the event of an emergency. The Firm will compensate X with a percentage of trading profits.

The Firm states that X will enter his orders into the Firm's two primary internet-based trading systems, Bloomberg and Net Exchange Pro.⁵ The Firm will be able to monitor X's market-marking activities, risk parameters, and order executions in real time through access to these systems. When X enters orders into either trading system from his desktop terminal in City 2, the trades will appear simultaneously on the Proposed Supervisor's desktop terminal in City 1.

The Sponsoring Firm proposes that the Proposed Supervisor will continue to be X's primary, responsible supervisor. The Proposed Supervisor is a manager and registered principal of the Firm. He has been employed by the Sponsoring Firm in its City 1 office since July 2003 and has been supervising X since he joined the Firm in February 2004. The Proposed Supervisor became associated as a general securities representative in November 1969, a general securities principal in June 1988, and an equity trader in November 1999.

³ X maintains that he must relocate to City 2 for pressing personal reasons.

⁴ NASD Conduct Rule 3010(g)(1) states, in part, that "Office of Supervisory Jurisdiction" means any office of a member at which any one or more of the following functions take place: (A) order execution and/or market making. Further, NASD Conduct Rule 3010(a)(4) requires the designation of one or more appropriately registered principals in each OSJ.

⁵ The Net Exchange Pro system is provided by the Sponsoring Firm's clearing firm, Firm 1.

The Proposed Supervisor has no past or pending disciplinary or regulatory proceedings, complaints, or arbitrations.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be approved, subject to the specified terms and conditions of heightened supervision over X set forth below.

VI. Discussion

After carefully reviewing the entire record in this matter, we concur with Member Regulation's recommendation and approve the Firm's Application to continue to employ X as a general securities principal, subject to the supervisory terms and conditions set forth below.

In reaching our determination, we first consider the nature and gravity of X's statutorily disqualifying event and acknowledge that it involved securities-related misconduct and an NASD bar as a principal. We note, however, that the actual misconduct occurred almost 20 years ago and that X's disciplinary record has been unblemished ever since.⁶ We further note that the NASD District Committee that entered the Order of Settlement in 1988, specifically stated that X's former principal was "the most culpable" and that:

[w]ith respect to Respondent X's offer, we believe that a bar in any principal capacity is a severe sanction, especially when you consider that Respondent X is only 30 years old. In only imposing a ten day suspension in all capacities and a \$2,000.00 fine we recognize that Respondent X was used by [the principal of the firm and the unregistered individual] to further their own interests and that his participation in these violations was due more to stupidity than any intent to violate our rules. We believe that a bar in any principal capacity should prevent Respondent X from future similar misconduct.

X has been forthcoming in his disclosures to securities regulators regarding his statutory disqualification. He has registered with various firms as a general securities representative since the 1988 NASD settlement barring him as a principal, but he has not sought to be reinstated as a principal until the instant Application. Having had the opportunity to assess X's demeanor during his testimony and his record in the industry, we believe that he does not pose a threat to

⁶ X submitted a statement with the Application that described the circumstances that existed at the time of his misconduct. He accepted full responsibility for his actions, but explained that he was unaware at the time that the principal of his former firm had designated X, in writing, as the supervisor for the unregistered individual who engaged in the unauthorized transactions and excessive trading of customers' accounts.

the investing public or the markets by returning to the securities industry as a principal under the conditions proposed by the Sponsoring Firm.

The Firm represents that although X will be physically relocating to a home office in City 2, there will be no material change in the duties that he has been performing for the Firm since February 2004. X will not have any supervisory responsibilities over personnel and will continue to work as a trader and report to the same supervisor, the Proposed Supervisor. X will, however, be designated as a general securities principal because he will be conducting market-making activity on behalf of the Firm out of his home office.

The Proposed Supervisor has been in the securities industry for almost 30 years without disciplinary history and is well qualified to supervise market-making activities. Since X will be in a different physical location from the Proposed Supervisor, the heightened plan of supervision includes the fact that every trade entered by X from City 2 will simultaneously appear on the Proposed Supervisor's computer screen in City 1. Thus the Proposed Supervisor will have the opportunity to provide real time review of X's activities.

Moreover, the Firm has been an NASD member since 1984, and although it has some disciplinary history, we are not concerned that this history will have an impact on its ability to supervise X in his proposed role at the Firm. The Firm has agreed to a comprehensive supervisory plan to ensure that it will be able to maintain future compliance with the plan of heightened supervision for X.

Accordingly, we believe that permitting the Sponsoring Firm to continue to employ X as a general securities principal poses no threat to the public interest and does not create an unreasonable risk of harm to the market or investors.

In approving this Application, we impose the following specific supervisory procedures and operating restrictions on the Sponsoring Firm and the Proposed Supervisor:⁷

1. The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;
2. X will enter orders into the Firm's Bloomberg or Net Exchange Pro trading systems, which the Proposed Supervisor will review in real time;
3. X will have a dedicated phone line;*
4. X will not have the ability to send faxes; he will only be able to receive faxes;*

⁷ The Firm has indicated that those supervisory terms and conditions denoted with an asterisk (*) are special for X and are not required of the Firm's other registered principals.

5. The Proposed Supervisor will review all of X's trading transactions on a daily basis;
6. The Firm will capture and retain in a central database all email messages sent and received by X, to be reviewed on a monthly basis. This review will include email messages maintained by any vendor, including Bloomberg. In addition to its standard review, the Firm's Compliance Department will review a sample of the monthly volume that will reasonably guarantee compliance with the heightened supervisory conditions imposed on X. If any problems arise with respect to communications contained within these messages, the Compliance Department will forward them to the president of the Firm to determine the appropriate action. The Firm will keep records of any review and deficiencies segregated for ease of review during X's statutory disqualification examinations;*
7. X will also have access to "instant messenger" accounts. The Firm will capture and retain in a central database all instant messages to and from X, to be reviewed on a monthly basis. This review will include instant messenger accounts maintained by any vendor, including Bloomberg. As in the case of email messages, in addition to its standard review, the Firm's Compliance Department will review a random sample of the monthly volume that will reasonably guarantee compliance with the heightened supervisory conditions imposed on X. If any problems arise with respect to communications contained within these messages, the Compliance Department will forward them to the president of the Firm to determine the appropriate action. The Firm will keep records of any review and deficiencies segregated for ease of review during X's statutory disqualification examinations;*
8. X will not meet with clients or keep client records at his City 2 home office;*
9. X will not accept any funds or securities at his City 2 home office;*
10. A designated principal will inspect X's City 2 home office within the first three months of its opening and no less than annually thereafter. The Firm's Compliance Department will maintain evidence of such reviews at the Firm's City 1 office;*
11. X will not have any direct supervision over employees of the Sponsoring Firm;*
12. All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the Compliance Department. The Proposed Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. The Firm will keep documents pertaining to these complaints segregated for ease of review;
13. The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Compliance Department of the Sponsoring Firm that X and the Proposed Supervisor are in compliance with all of the conditions of heightened supervision to be accorded X;* and

14. 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 supervisor from the Proposed Supervisor to another person.*

NASD certifies that: 1) X meets all applicable requirements for the proposed employment; 2) the Firm is also a member of the Pacific Stock Exchange which will receive a copy of this 19h-1 Notice; 3) the Firm has represented that X and the Proposed Supervisor are not related by blood or marriage; and 4) the Firm represents that it employs no other statutorily disqualified individuals.

Accordingly, we approve the Sponsoring Firm's Application to continue to employ X as a general securities principal from his home office in City 2, State 1. In conformity with the provisions of SEC Rule 19h-1, the continued association of X as a general securities principal with the Firm will become effective within 30 days of the receipt of this notice by the Commission, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary