

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Continued Association of X as a General Securities Representative with The Sponsoring Firm	Redacted Decision <u>Notice Pursuant to Rule 19h-1 Securities Exchange Act of 1934</u> <u>Decision No. SD06013</u> Date: 2006
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I. Introduction

On August 29, 2005, the Sponsoring Firm¹ (“the Firm”) submitted a Membership Continuance Application (“MC-400” or “the Application”) with NASD’s Department of 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. In June 2006, a subcommittee (“Hearing Panel”) of NASD’s Statutory Disqualification Committee held a hearing on the matter.² X appeared at the hearing, accompanied by his Proposed Supervisor and the chief compliance officer for the Firm’s parent company.³ X’s counsel appeared by telephone. LL appeared on behalf of NASD’s Department of Member Regulation (“Member Regulation”).

For the reasons explained below, we approve the Application.

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 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).

³ The CCO1 appeared at the hearing instead of the Firm’s current Chief Compliance Officer, CCO2, because the CCO1 had been the Firm’s Chief Compliance Officer when the Firm filed its MC-400 and he was more familiar with the Application.

II. The Statutorily Disqualifying Event

X is statutorily disqualified because he willfully failed to disclose on his Uniform Application for Securities Industry Registration or Transfer (“Form U4”) that he had been charged with, and pled guilty to, felony possession of cocaine in State 1. In May 2005, NASD’s Department of Enforcement (“Enforcement”) issued X an Order Accepting Offer of Settlement (“Order”) for his willful failure to disclose a material fact on Forms U4 from May 2001, until June 2003. *See* Art. III, Sec. 4(f) of NASD’s By-Laws.⁴ This period of time covered X’s failure to amend his Form U4 while he was associated with another member firm until June 2003, and his failure to disclose the felony charge and guilty plea on the initial Form U4 that he filed with the Sponsoring Firm in June 2003.⁵ The Order fined X \$2,500⁶ and suspended him from association in all capacities for two months. The suspension began June 2005, and ended August 2005.

The underlying criminal event that led to X’s failure to disclose was an April 2001 felony charge for possession of cocaine and a September 2002 guilty plea to the offense. In addition to

⁴ Following its investigation of the matter, Enforcement had a choice as to whether it would proceed against X for a willful violation, or a non-willful violation. The distinction between a willful and non-willful failure to disclose is critical because a willful failure results in a lifetime statutory disqualification under the Securities Exchange Act of 1934 (“the Exchange Act”) and the NASD By-Laws. Art. III, Sec. 4(f) of NASD’s By-Laws provides that a person is subject to a statutory disqualification if that person:

has willfully made or caused to be made in any application . . . to become associated with a member of a self-regulatory organization, . . . any statement which was at the time, and in light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application . . . any material fact which is required to be stated therein.

⁵ The Order actually states that X submitted an initial Form U4 to the Sponsoring Firm “on or about May 19, 2003.” X’s NASD Central Registration Depository (“CRD”[®]) record, however, indicates that X filed an initial Form U4 with the Sponsoring Firm in June 2003, which is also the date that appears on the copy of the earliest Form U4 submitted to the Sponsoring Firm by X in the record before us.

⁶ The Order specifically states that the “amount of the fine accounts for the fact that [X] was fined \$5,000 by the Sponsoring Firm, and he paid the fine to the Sponsoring Firm.” The record shows that the Sponsoring Firm conducted an investigation into X’s failure to disclose and concluded that X made “an honest mistake” in not disclosing the criminal event, and that he did “not intend to mislead or conceal this information from [the Firm].” Nonetheless, “given the seriousness of the matter,” the Firm determined that “it was appropriate to penalize [X] for his failure to disclose the event and levied a substantial \$5,000 fine against him.”

pleading guilty in September 2002, X agreed to enter a drug treatment diversion program. Pursuant to this program, first-time drug offenders in State 1 are given the option of pleading guilty, and then having the judge “defer” the entry of judgment. Pursuant to the terms of the program, if the defendant successfully completes the ordered treatment or program, then the court will dismiss the criminal charges against the defendant. Thus, here, the state court judge did not make a finding of guilt or accept X’s plea of guilty, but rather held X’s guilty plea in abeyance because he agreed to enter a drug treatment diversion program. X successfully completed the program, and in September 2003, the judge dismissed the felony charge against X. Accordingly, X was never “convicted” of a felony, and thus the felony cocaine possession incident is not a separate statutorily disqualifying event.⁷

III. Background Information

A. X

X first registered in the securities industry as a general securities representative (Series 7) in November 1984. He has been associated with the Sponsoring Firm since June 2003.

X was previously associated with three other member firms. He was associated with Firm One when he was charged with, and pled guilty to, the felony offense in 2001 and 2002. As noted above, X did not disclose the facts pertaining to the felony offense to Firm One on a Form U4 amendment, nor did he disclose the felony charge and guilty plea to the Sponsoring Firm when he first submitted a Form U4 to the Firm in June 2003.

CRD shows no other disciplinary actions against X.

B. The Firm

The Sponsoring Firm is based in State 2 and became an NASD member in June 1998. The Firm is a full-service broker-dealer that has 228 branch offices, 216 offices of supervisory jurisdiction (“OSJ”), 379 registered principals, 1229 registered representatives, and 105 other employees.

1. NASD Disciplinary History

NASD conducted routine examinations of the Firm in 2001, 2003, and 2005. Following the 2001 examination, NASD issued the Firm a Letter of Caution (“LOC”) dated 2001, for

⁷ See Letter from Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC, to Peggy Germino, Manager, Qualifications and Registration Department, NYSE (Nov. 9, 2000) (stating that a person who enters a pretrial diversionary program has not been convicted for disqualification purposes because the court has not accepted a plea or otherwise rendered a finding of guilt).

several violations, including failing to timely report two customer complaints, failing to timely update Forms U4 with customer complaint information, and trade reporting infractions. The Sponsoring Firm responded by letter dated January 2002, listing the actions it had taken with regard to the deficiencies noted by NASD.

The 2003 examination resulted in NASD entering into a Letter of Acceptance, Waiver, and Consent (“AWC”), dated 2004, with the Firm and issuing a separate LOC. The AWC fined the Firm \$100,000 based on findings that the Firm failed to establish and maintain adequate written procedures reasonably designed to prevent late trading in mutual fund transactions and to ensure that orders received after the close of the market were processed at the next day’s net asset value. NASD also issued the Sponsoring Firm an LOC dated 2004, that cited the Firm for inadequate written supervisory procedures, books and records violations, and untimely Form U4 disclosures to NASD. The Sponsoring Firm responded to the LOC by letter dated July 2004, listing the measures it had taken to correct the problems noted by NASD.

The 2005 examination resulted in an LOC dated 2006, citing the Firm for several infractions, including failing to timely report four customer complaints, failing to timely update Forms U4 with customer complaint information, inadequate written supervisory procedures, inaccurate Forms U4, untimely filing of Uniform Termination Notices for Securities Industry Registration (“Forms U5”), continuing education requirements violations, books and records violations, and six excessive commissions transactions. The Firm responded to the LOC by letter dated June 2006, stating that it had addressed and corrected the deficiencies noted by NASD.

In addition to the routine examinations, NASD also conducted two other investigations that led to the submission of AWCs by the Firm in 2005, and 2006. The 2005 AWC cited the Firm for improper sales contests and “directed brokerage violations” – recommending the purchase of mutual fund shares on the basis of brokerage commissions received or expected to be received by the Firm. NASD fined the Sponsoring Firm \$1,308,000 for these infractions.

The 2006 AWC fined the Firm \$315,000 for inadequate disclosures of breakpoint discounts and unsuitable recommendations of Class B and Class C shares of mutual funds.

2. State Disciplinary History

In June 2001, the State 3 Department of Banking and Finance (n/k/a Office of Financial Regulation) fined the Sponsoring Firm \$10,000 and imposed a cease and desist order because the Firm failed to register two branch offices in State 3. State 3 subsequently approved both branch offices to conduct business in the state.

In August 2003, the State 3 Office of Financial Regulation fined the Sponsoring Firm \$3,500 and imposed a cease and desist order because the Firm failed to register offices in State 3. State 3 later approved the offices to conduct business in the state.

The record shows no other recent complaints, disciplinary proceedings, or arbitrations against the Sponsoring Firm.

IV. X's Proposed Business Activities and Supervision

The Firm proposes to continue to employ X as a general securities representative in its branch office in State 1. Only one other representative, who only conducts several transactions per year, works from this office. The Sponsoring Firm will compensate X on a commission basis.

The Sponsoring Firm proposes that the Proposed Supervisor will continue to be X's primary, responsible supervisor. The Proposed Supervisor has been employed by the Firm since June 2003 and is the OSJ manager at the Firm's State 1 office, which is approximately 60 miles from X's branch office. She is currently supervising X pursuant to certain heightened supervisory conditions that the Firm has imposed since it filed the MC-400 on August 29, 2005.⁸ She has been employed in the securities industry since 1993, becoming registered as a uniform securities agent (Series 63) in July 1993, a general securities representative (Series 7) in October 1999, and a general securities principal (Series 24) in December 1999.

⁸ The Proposed Supervisor testified that these heightened supervisory conditions are as follows:

1. The Proposed Supervisor pre-approves all of X's transactions entered for an amount of \$5,000 or more, prior to their being submitted to the sponsor or custodian. In the event that the Proposed Supervisor is unavailable, X may obtain pre-approval by contacting the Proposed Supervisor's designated supervisory principal or the Firm's Compliance Department. X must submit copies of the complete mutual fund or annuity applications and all other transactional and suitability documentation to his designated supervising principal in advance of placing the trade. Such transmittals will be reviewed, and will be approved, rejected, or pended for additional information in writing. X will not submit any transaction for execution until he has received written approval, by the Proposed Supervisor or another designated supervisor;
2. X must submit his purchase and sales blotter to the Proposed Supervisor on a daily basis;
3. The Proposed Supervisor must pre-approve all of X's outgoing client correspondence prior to mailing;
4. X must forward all of his incoming client correspondence to the Proposed Supervisor within 24 hours of receipt; and
5. Until further notice, the Firm will conduct semi-annual branch office examinations of X's location. These examinations will be conducted on an unannounced basis, and X will be responsible for the associated cost.

The Proposed Supervisor was previously associated with four other member firms from June 1993 until June 2003. The Proposed Supervisor was associated with Firm One from July 1998 until June 2003, which coincided with X's association with Firm One from April 1998 until June 2003.

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

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 approve the Application to continue to employ X as a general securities representative, subject to the supervisory terms and conditions set forth below.

In reviewing the Application, we assess the totality of the circumstances in reaching a judgment about X's 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 his business. For the reasons set forth below, we conclude that X's continued participation in the securities industry will not present an unreasonable risk of harm to the market or investors.

We acknowledge that X, as a registered representative, was responsible for knowing the rules of the securities industry and for providing accurate information about his 2001 felony charge and 2002 guilty plea to Firm One on a timely basis to update his Form U4, and to the Sponsoring Firm when he submitted an initial Form U4 in June 2003. *See, e.g., Robert E. Kauffman*, 51 S.E.C. 838, 840 (1993) ("Every person submitting registration documents [to NASD] has the obligation to ensure that the information printed therein is true and accurate."), *aff'd*, 40 F.3d 1240 (3d Cir. 1994) (table). At the hearing, X testified that he now understands his mistake and realizes that he must disclose the felony charge on all future Forms U4. X also, however, provided written statements and testified at the hearing that he had previously believed, based on discussions with his attorney, the state court judge, and the drug diversion program counselors, that due to his agreement to enter the drug diversion program, "[his] guilty plea would be held by the judge and would not be accepted." X maintained that he therefore erroneously believed that he was absolved of any duty to disclose the felony charge and guilty plea because the drug diversion program would ultimately lead to the dismissal of all charges against him.

In determining to approve the Application, we have also considered that X's failure to amend his Forms U4 has previously been addressed by Enforcement's May 2005 Order. Enforcement evaluated all of the circumstances regarding X's failure to disclose and determined to impose a two-month suspension in all capacities and a \$2,500 fine. Enforcement also noted in

the Order that the Sponsoring Firm had investigated X's non-disclosure and had imposed a separate \$5,000 fine.

We further note that there is no indication in the record that X has engaged in any intervening misconduct since Enforcement's Order and that he has been employed in the securities industry for 22 years and has no other disciplinary history or customer complaints.

The Proposed Supervisor appears qualified to continue to supervise X. She has worked in the securities industry since 1993 with no disciplinary history or customer complaints. We note that although she is physically located 60 miles from X's branch office, she has been successfully supervising X pursuant to certain heightened conditions imposed by the Firm more than one year ago. We believe that she will be similarly successful in supervising X pursuant to the newly enhanced heightened supervisory conditions set forth below.

The Firm does have a disciplinary history which we have taken into account in our assessment of the Application. In particular, we are concerned that NASD's routine examinations of the Firm in 2001 and 2005 both resulted in LOCs that cited the Firm for failure to timely report customer complaints. This matter has been addressed in the required heightened supervisory procedures listed below by requiring X to disclose to the Proposed Supervisor, within two business days, events such as a criminal charge or conviction; a problem with a customer, even if the problem did not result in a customer complaint; or an issue that is related to his job performance at the Firm. The Proposed Supervisor must immediately refer each matter to the Firm's Compliance Department, and the director of compliance must investigate every matter brought to his or her attention. Each event and the outcome must be documented by the Firm in writing and kept segregated for ease of review during any NASD statutory disqualification audit.

Further, the Firm currently employs one other individual, Employee 1, who is statutorily disqualified based on a 1998 felony conviction for driving under the influence of alcohol. Employee 1 has been employed by the Sponsoring Firm since May 2004, in a branch office in State 4. NASD's District Office has conducted yearly statutory disqualification examinations of the office where Employee 1 is located, and it filed them "without action," meaning that it had not noted any issues that warranted concern or further investigation.

Finally, we also note that the Firm's current Chief Compliance Officer, CCO 2, has no disciplinary history, and the Firm has agreed to a comprehensive supervisory plan to ensure that it will be able to maintain heightened supervision for X.

Given these factors, we conclude that the following supervisory conditions agreed to by the Sponsoring Firm will provide the enhanced compliance measures necessary to monitor X's activities:⁹

⁹ The items denoted by an asterisk are heightened supervisory conditions and not standard operating procedures of the Firm.

1. *The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;
2. If the Proposed Supervisor is to be on vacation or out of the office, the Proposed Supervisor 2 will act as X's interim supervisor;¹⁰
3. X will not maintain discretionary accounts;
4. *X will not act in a supervisory capacity;
5. *The Proposed Supervisor will pre-approve all of X's transactions entered for an amount of \$5,000 or more, prior to their being submitted to the sponsor or custodian. X must submit copies of the complete mutual fund or annuity applications and all other transactional and suitability documentation to the Proposed Supervisor in advance of placing a trade. The Proposed Supervisor will review such transmittals, and approve, reject, or request additional information on them in writing. X will not submit any transaction for execution until he has received written approval from the Proposed Supervisor;
6. The Proposed Supervisor will review all of X's transactions entered for an amount less than \$5,000 on a daily basis;
7. *X must submit his purchase and sales blotter to the Proposed Supervisor on a daily basis;
8. *The Proposed Supervisor must pre-approve X's outgoing client correspondence prior to mailing;
9. *X must forward all of his incoming client correspondence to the Proposed Supervisor within 24 hours of receipt;
10. *Until further notice, the Firm will conduct semi-annual branch office examinations of X's location. These examinations will be conducted on an unannounced basis, and X will be responsible for the associated cost;
11. X will be permitted to conduct sales calls outside of the office;
12. X is not, under any circumstances, permitted to accept cash from a customer or client;

¹⁰ The Proposed Supervisor 2 has been registered in the securities industry since 1993. She became a general securities principal in August 1995 and has no disciplinary history.

13. *For the purposes of client communication, X is only allowed to maintain an e-mail account that is held at the Firm, with all e-mails being filtered through the Firm's system. The Proposed Supervisor will conduct a weekly review of all e-mail messages that X sends or receives. The Proposed Supervisor will print out the e-mail messages and keep them segregated for ease of review during any statutory disqualification audit;
14. *X must disclose to the Proposed Supervisor, within two business days, events such as a criminal charge or conviction; a problem with a customer, even if the problem did not result in a customer complaint; or an issue that is related to his job performance at the Firm. Once the Proposed Supervisor is made aware of such an event, she must immediately refer the matter to the Firm's Compliance Department. The Chief Compliance Officer must investigate every event brought to her attention, and document the event and its outcome in a writing to be kept segregated for ease of review during any statutory disqualification audit;
15. *All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the Firm's Compliance Department. The Proposed Supervisor will prepare a memorandum to the file as to what measures she took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. The Proposed Supervisor will keep documents pertaining to these complaints segregated for ease of review;
16. *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; and
17. *The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Firm's Compliance Department that she and X are in compliance with all of the above conditions of heightened supervision.

NASD 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; and 3) the Firm has represented that X and the Proposed Supervisor are not related by blood or marriage.

VII. Conclusion

Accordingly, we approve the Sponsoring Firm's Application to continue to employ X as a general securities representative. In conformity with the provisions of SEC Rule 19h-1, the continued association of X as a general securities representative 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