

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Association of  X  as an  Limited Representative - Investment Company Products and Variable Contracts Products  with  The Sponsoring Firm	Redacted Decision  <u>Notice Pursuant to Rule 19h-1 Securities Exchange Act of 1934</u>  <u>Decision No. SD06015</u>  Date: 2006
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**I. Introduction**

On December 8, 2005, the Sponsoring Firm<sup>1</sup> (“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 associate with the Firm as a limited representative – investment company and variable contracts products. In April 2006, a subcommittee (“Hearing Panel”) of NASD’s Statutory Disqualification Committee held a hearing on the matter.<sup>2</sup> X appeared at the hearing, accompanied by his counsel of Firm 4 and by his Proposed Supervisor. LL and JK appeared on behalf of NASD’s Department of Member Regulation (“Member Regulation”).

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

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<sup>1</sup> The names of the Statutorily Disqualified individual, the Sponsoring Firm, the Proposed Supervisor and other information deemed reasonably necessary to maintain confidentiality have been redacted.

<sup>2</sup> 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).

## II. The Statutorily Disqualifying Event

X is statutorily disqualified because he pled “no contest” in January 2005, in a State 1 court to eight counts of campaign finance violations.<sup>3</sup> The charges stemmed from X’s successful campaign for Village President (“Mayor”) of City 1, State 1.<sup>4</sup> He served as Mayor of that town, part-time, from April 2003, until January 2005.<sup>5</sup> The court ordered X to pay \$1,480 (which included total forfeiture payments of \$564.52), and X agreed to resign as Mayor of City 1.<sup>6</sup>

## III. Background Information

### A. X

X first registered in the securities industry as a uniform securities agent (Series 63) in November 1989 and he qualified as a limited representative – investment company and variable contracts products (Series 6) in January 1990.

X was previously associated with Firm One from October 1989 until January 2000; and Firm Two from October 1989 until February 2005. X filed a Uniform Application for Securities Industry Registration or Transfer (“Form U4”) with Firm Three in March 2005, but Firm Three declined to sponsor him as a statutorily disqualified person, and X voluntarily resigned from Firm Three in April 2005. Currently, X is working as an independent insurance agent.

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<sup>3</sup> Five of the counts were town ordinance violations and three were misdemeanors. The three misdemeanor offenses qualify as statutorily disqualifying events under Art. III, Sec. 4(g)(1)(i) of NASD’s By-Laws (involving a misdemeanor conviction within 10 years preceding the filing of an application for association with a member of NASD for a misdemeanor that involved the making of a false report).

<sup>4</sup> Briefly, the eight charges against X were as follows: Counts 1-3 – ordinance violations for failing to provide in campaign reports the full name and address of each contributor to X’s campaign; Count 4 – ordinance violations for making disbursements through electronic transfers from X’s campaign depository account to his personal account without using a negotiable instrument; Count 5 – misdemeanor for receiving funds from entities, rather than individuals, in violation of State 1 statute; Count 6 – misdemeanor for submitting a false report by not listing each contributor of more than \$20 on campaign finance reports; Count 7 –misdemeanor for submitting a false report by reporting campaign fund disbursements as having been made directly to the U.S. post office and postage and box rental, when X actually made the purchases personally and the campaign reimbursed him; and Count 8 – ordinance violations for failing to provide in continuing campaign reports the full name and street address of each contributor to X’s mayoral campaign.

<sup>5</sup> As Mayor, X received an annual salary of \$7,500 plus \$75 per month for expenses.

<sup>6</sup> At the hearing, X testified that his resignation as Mayor was the ultimate goal sought by his “opposition” from the mayoral campaign that had led the investigation against him.

NASD's Central Registration Depository ("CRD"<sup>®</sup>) shows that when X was with Firm Two, he was "under investigation for a possible signature irregularity found in his files." Firm Two stated that its investigation was "inconclusive." NASD's District Office also conducted an inquiry into this event and issued a letter to X in April 2005, stating that it had determined not to pursue any further action. X testified at the hearing that, in response to an inquiry from a health insurance company that a client's signature on a document "looked funny," he had "cut out a signature on an old life insurance application to verify the client's signature and faxed it to the health insurance company."<sup>7</sup> X also testified that this signature had not been used to purchase any product on behalf of the client.

Firm Two discharged X in February 2005, stating on the Uniform Termination Notice for Securities Registration ("Form U5") that the reason for discharge was his January 2005 conviction for campaign finance violations, including preparing and submitting a false report.

The record shows no other regulatory actions against X.

#### B. The Firm

The Sponsoring Firm was formed in 1993 and became an NASD member in November 1995. The Firm is based in City 1, State 1, and has no branch offices and one office of supervisory jurisdiction ("OSJ") that is also the Firm's home office. The Firm employs one registered principal, three registered representatives, and two part-time employees. The Firm represents that it is engaged in the "sale of mutual funds, variable contracts and municipal securities (529 Plans only)."

NASD has begun, but not yet completed, a 2006 alternative municipal examination of the Firm. NASD's 2004 routine examination of the Firm found no deficiencies. NASD issued Letters of Caution ("LOCs") to the Firm for the 2000 and 1996 routine examinations.

The 2000 LOC cited the Firm for books and records violations, one net capital computation violation, one inaccurate FOCUS report filing, and failure to maintain copies of Forms U5 filed by previous employers for certain registered representatives. The Firm responded in a letter dated August 2000, listing the actions it had taken with regard to the deficiencies noted by NASD.

The 1996 LOC cited the Firm for continuing education program violations and inaccurate entries on order tickets. The Firm responded in a letter dated July 1996, stating the measures 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**

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<sup>7</sup> X earlier provided this information on a Disclosure Reporting Page filed with CRD.

The Firm proposes to employ X as a limited representative – investment company and variable contracts products in its home office in City 1, State 1. The Firm will compensate X on a commission basis.

The Sponsoring Firm proposes that the Proposed Supervisor will be X's primary, responsible supervisor. The Proposed Supervisor has been employed by the Firm since March 1993, is the Firm's president, and is located at the home office where X will be employed. The Proposed Supervisor has been employed in the securities industry since 1988, becoming registered as a limited representative – investment company and variable contracts products in July 1988, a general securities representative (Series 7) in January 1989, a general securities principal (Series 24) in April 1995, a financial and operations principal (Series 27) in June 1995, and a municipal fund securities limited principal (Series 51) in September 2003.

The Proposed Supervisor was previously associated with Firm A from December 1986 until February 1993, and Firm B from June 1993 until November 1995.

The record shows no 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 Firm's Application to employ X as a limited representative – investment company and variable contracts products, subject to the supervisory terms and conditions set forth below.

In reviewing this type of application, we have considered whether the particular criminal offense at issue, examined in light of the circumstances related to the offense, and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.<sup>8</sup> 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 his business.

For the reasons set forth below, we conclude that X's participation in the securities industry will not present an unreasonable risk of harm to the market or investors.

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<sup>8</sup> 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 criminal offenses "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).

The original complaint against X charged 29 campaign finance violations. The amended complaint reduced the allegations to eight counts, five of which were ordinance violations and three of which were misdemeanor violations. These remaining violations amounted to little more than minor recordkeeping issues, such as: 1) failing to list the names of each contributor of more than \$20 when checks were submitted by a couple, neither of whom had contributed more than \$20; 2) accepting funds of \$140 from entities, rather than individuals (X testified that he returned these funds to the contributors within one day of his being made aware that the entities were ineligible to contribute); and 3) reporting campaign fund disbursements as having been made directly to the U.S. post office, when X actually made the purchases personally and the campaign reimbursed him. The record shows that X returned all funds as soon as he was aware that he was not entitled to receive them, and that he never took any money from his campaign that he was not entitled to for reimbursement of expenses. X testified that he had never run for elected office before and that he had a designated campaign treasurer who handled 90% of his campaign finance records. After examining the voluminous records that were produced by X during his campaign, and hearing his testimony, we find that he does not present an unreasonable risk of harm to the market or investors.

Further, X has participated in the securities industry for 17 years with no disciplinary history and no customer complaints. The inquiry at Firm Two for “possible signature irregularity” was filed as “inconclusive” by the Firm and resulted in no action by NASD’s District Office in 2005. Firm Two ultimately terminated X in February 2005, due to the 2005 misdemeanor conviction and the resulting statutory disqualification.

The Proposed Supervisor is well qualified and has worked in the securities industry since 1988 with no disciplinary history.

The Sponsoring Firm is a long-standing member of NASD, with no formal disciplinary history. The Firm has agreed to a comprehensive supervisory plan to ensure that it will be able to maintain heightened supervision for X.

In sum, given the nature of X’s misdemeanor offenses and the fact that he previously has been successfully employed in the securities industry, 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:<sup>9</sup>

1. The Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;
2. X will not maintain discretionary accounts;
3. X will not act in a supervisory capacity;

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

4. \*the Proposed Supervisor will supervise X on-site, in the home office;
5. X will be permitted to conduct sales calls outside of the office;
6. \*The Proposed Supervisor will review and pre-approve each customer account prior to the opening of the account by X. The Proposed Supervisor will document his review and approval by signing and dating the paperwork and maintaining it at the Firm's home office for audit purposes;
7. \*At the end of each month, the Proposed Supervisor will run a transaction report detailing X's sales activity. From that report, the Proposed Supervisor will randomly contact at least two of X's clients to assess how X serviced their accounts. The Proposed Supervisor will memorialize his findings in the form of a Memo to File ("Memo"). The Proposed Supervisor will print this Memo and segregate it for ease of review during any statutory disqualification audit;
8. The Proposed Supervisor will personally meet with X on a quarterly basis to review all aspects of his business;
9. \*X will not, under any circumstances, be permitted to accept cash. All client checks must be made payable to the Firm or a mutual fund, and X must forward them to the Firm on the day they are received;
10. The Proposed Supervisor will review X's incoming correspondence (which includes e-mail communications) upon its arrival and will review outgoing correspondence before X sends it out;
11. \*For the purposes of client communication, X will only be allowed to maintain an e-mail account that is held at the Firm and all e-mails will be filtered through the Proposed Supervisor's e-mail system. The Proposed Supervisor will conduct a weekly review of all e-mail messages that X sends or receives. The Proposed Supervisor will print these e-mail messages and keep them segregated for ease of review during any statutory disqualification audit (in addition to complying with the e-mail retention requirements in NASD Rule 3110 and Rules 17a-3 and 17a-4 of the Securities Exchange Act of 1934);
12. \*When the Proposed Supervisor is out of the office, he will continue to monitor X to ensure that X is complying with the terms and conditions of the heightened plan of supervision;
13. \*X will not open new accounts in the Proposed Supervisor's absence. X will refer any potential clients directly to mutual fund families for liquidations, purchases or exchanges. As to X's existing clients, he will be permitted to engage in liquidations, purchases or exchanges, but upon the Proposed Supervisor's return to the office, the Proposed Supervisor will review any such activity in X's

accounts and will evidence his review by signing and dating the paperwork and segregating it for ease of review;

14. \*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 he 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;
15. \*For the duration of X's statutory disqualification, the 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
16. \*The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Firm's Compliance Department that he and X are in compliance with all of the above conditions of heightened supervision to be accorded X.

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; 3) the Firm has represented that the Proposed Supervisor and X are not related by blood or marriage; and 4) the Firm currently employs no other statutorily disqualified individuals.

## **VII. Conclusion**

Accordingly, we approve the Sponsoring Firm's Application to employ X as a limited representative – investment company and variable contracts products. In conformity with the provisions of SEC Rule 19h-1, the association of X as a limited representative – investment company and variable contracts products 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,

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Barbara Z. Sweeney  
Senior Vice President and Corporate Secretary