PLEASE NOTE THE LATER CASE HISTORY OF THIS DECISION FOLLOWING THE TEXT OF THE DECISION.

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
NASD

In the Matter of X as a Limited Representative – Corporate Securities Representative with The Sponsoring Firm	**Redacted Decision** Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 Decision No. SD 05010 Dated: 2005

On February 22, 2005, the Securities and Exchange Commission remanded a, 2003[1] National Adjudicatory Council ("NAC") decision denying a statutory disqualification application that sought to permit X to associate as a limited representative – corporate securities representative[2] with the Sponsoring Firm ("the Firm").[3] The Commission rejected the NAC's conclusion that the Commission's previous decisions in *Paul Edward Van Dusen*, 47 S.E.C. 668 (1981) and *Arthur H. Ross*, 50 S.E.C. 1082 (1992) did not apply to X's application. The Commission stated that NASD should employ the analysis set forth in *Van Dusen* and *Ross* not only when considering applications from individuals who have received Commission administrative bars with a right to reapply, but also when evaluating applications, similar to the one at issue in this case, from statutorily disqualified persons who have received other Commission administrative sanctions under the Securities Exchange Act of 1934 ("the Exchange Act").

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[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 Membership Rule 1032(e), a limited representative – corporate securities representative is not permitted to engage in transactions that involve municipal securities, options, redeemable securities (except for money market funds), variable contracts, or direct participation programs.

[3] *[CASE REDACTED]*.

In light of the Commission's instructions, the NAC has considered the Firm's renewed application and has determined to deny its request for X to return to the securities industry.[4]

I. Introduction

This action was initiated on March 13, 2003, when the Sponsoring Firm completed a Membership Continuance Application ("MC-400" or "the Application") seeking to permit X to associate with the Sponsoring Firm. In April 2003, a subcommittee ("Hearing Panel") of the Statutory Disqualification Committee of the NAC held a hearing on the matter. X appeared, accompanied by counsel, AD, and by the Firm's former Chief Compliance Officer, Employee 1, who was then proposed as X's supervisor. Subsequently, in correspondence dated July 2003, the Firm advised NASD that Employee 1 was no longer employed by the Sponsoring Firm and proposed that the Firm's then Chief Operating Officer, serve as X's Proposed Supervisor. PL appeared on behalf of NASD's Department of Member Regulation ("Member Regulation").

The NAC denied the Sponsoring Firm's Application in a decision dated December 2003. The Sponsoring Firm appealed the denial to the Commission, which remanded the matter to the NAC in February 2005.

Following the Commission's remand, the Firm submitted letters dated March and May 2005, stating that it continues to support X's return to the securities industry under the same terms it proposed in its earlier Application, including having the Proposed Supervisor 1 serve as X's supervisor. In July 2005, Member Regulation responded to the Firm's newly proposed Application and recommended that it be denied.

In August 2005, the Remand Subcommittee sent a letter to the parties stating that NASD's Central Registration Depository ("CRD"®) reflected that the Firm had discharged the Proposed Supervisor 1 in June 2005, due to "company downsizing."[5] The Remand Subcommittee requested that the Firm submit the name of a different person to serve as X's supervisor and that Member Regulation review the new submission and submit a written recommendation on his or her qualifications to supervise X. In August 2005, the Firm submitted a revised Application, proposing that the Proposed Supervisor 2 serve as the primary supervisor for X. In September 2005, Member Regulation submitted its response and again recommended denial of the revised Application, as detailed further below.

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[4] The NAC appointed a subcommittee ("the Remand Subcommittee") to consider this matter on remand and make a written recommendation to the Statutory Disqualification Committee. In turn, the Statutory Disqualification Committee considered the Remand Subcommittee's recommendation and presented a written recommendation to the NAC, in accordance with NASD Procedural Rules 9524(a)(10) and 9524(b)(1).

[5] The Firm did not bring this fact to the attention of the Remand Subcommittee.

II. X's Statutorily Disqualifying Event

X is statutorily disqualified under Art. III, Sec. 4(h) of NASD's By-Laws because the U.S. District Court for the District of State 1 entered an Order of Permanent Injunction ("Permanent Injunction") against him in April 1969. The court permanently enjoined X from further violations of the anti-fraud provisions of the federal securities acts. The Permanent Injunction was based on a complaint issued by the Commission alleging that during late 1967 and early 1968, X participated in a scheme in which various lending institutions around the country were induced to make loans totaling more than $720,000, most of which went into default, to a company known as Firm 1. The two largest shareholders of Firm 1 stock perpetrated the scheme by contacting several traders, including X, and convincing them to insert quotations for Firm 1 stock in the "pink sheets"[6] at $10 bid, $12 asked, with an understanding that the traders would be protected against loss. X and others thus falsely created the appearance of a market for the Firm 1 stock collateralizing the loans. X, who at the time was a trader, vice-president, director and 30 percent shareholder of a broker-dealer, inserted 45 to 50 quotations per day in the pink sheets for Firm 1 stock on most days during the relevant time period. The Commission noted that X never questioned the protective arrangement, although it was a clear "red flag" that should have alerted him to inquire into the business and financial condition of Firm 1.[7]

NASD approved a previous application by X in 1971 to return to the securities industry. More recently, in October 1992, X was statutorily disqualified because he pled guilty in a State 2 state court to falsifying business records.[8] While he was employed as a trader by Firm 2, X agreed to "park" securities for another, now defunct broker-dealer. This misconduct resulted in false entries on both Firm 2's and the defunct broker-dealer's FOCUS reports. Firm 2 terminated X due to this misconduct and the state court sentenced him to a one-year period of conditional discharge. This conviction ceased to be a statutorily disqualifying event in October 2002.

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[6] The pink sheets were a daily publication for over-the-counter stocks previously published by The National Quotations Bureau LLC. The successor entity is Pink Sheets LLC®, a privately owned inter-dealer quotation system that displays quotes on over-the-counter equity securities.

[7] The Commission brought an administrative proceeding against X based on this same misconduct. In December 1971, X consented to an Order Instituting Public Administrative Proceeding, Making Findings and Imposing a Remedial Sanction that suspended him for three months in all capacities. *[CASE REDACTED]*. X completed that suspension in 1972.

[8] This misdemeanor qualifies as a statutorily disqualifying offense pursuant to NASD By-Laws, Art. III, Sec. 4(g)(1)(ii) (a conviction, within 10 years preceding the filing of any application for membership, for any felony or misdemeanor that arises out of the conduct of the business of a broker-dealer).

III. Background Information

A. X

X has not been employed by a broker-dealer since October 1992.[9] He first began working in the securities industry in May 1959 as an investment company products/variable contracts representative. He qualified as a general securities representative in July 1984 and as a limited representative-corporate securities representative in March 2000. He was associated with four different broker-dealers between 1959 and 1992.

Prior to the Sponsoring Firm's Application, three separate firms submitted MC-400 applications in support of X's return to the securities industry. As described below, NASD denied each of these applications, and the Commission affirmed the two denials that came before it on appeal.

In September 1993, NASD denied a firm's request for X to be associated as a general securities representative. As its basis for denial, NASD noted that X had engaged in two serious statutorily disqualifying activities, both of which involved securities-related misconduct. X did not appeal this denial to the Commission.

On July 21, 1995, NASD denied a second firm's MC-400 application for X to be associated as a general securities representative. NASD again expressed its concern with the serious nature of X's two securities-related offenses. In addition, NASD noted that the owner and control person of the second firm was also subject to a statutory disqualification. X appealed this denial to the Commission, which dismissed the appeal in April 1996. *[CASE REDACTED]*. The Commission affirmed NASD's determination that X's misconduct reflected poorly on his integrity and found that NASD's denial of the second firm's application had given proper regard to the public interest and the protection of investors.

On August 25, 2000, NASD denied a third firm's MC-400 application for X to be associated as a limited representative – corporate securities representative. NASD reiterated its concern with the nature of X's two securities-related statutorily disqualifying offenses and stated that X had demonstrated a pattern of securities-related misconduct. NASD also noted that it had found recent deficiencies in the supervisory procedures of one of the branch offices of the third firm and that the proposed supervisor was not qualified because he had very limited experience in the securities industry and had only been a general securities representative for a short time. X appealed this denial to the Commission, which dismissed the appeal in a decision dated May 2001. *[CASE REDACTED]*. The Commission stated that the third firm had proposed a new supervisor for X after appealing the NAC's decision to the Commission, but did not submit required information regarding the new supervisor's qualifications. Accordingly, the

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[9] X testified that since Firm 2 terminated him in 1992, he has been trading for his personal account and the accounts of his wife and stepdaughter.

Commission concluded that the record did not support the approval of X's proposed employment with the third firm.

B. The Firm

The Sponsoring Firm became a member of NASD in January 1980. The Firm has one main office in State 2 that is an office of supervisory jurisdiction ("OSJ") and six branch offices that are also registered as OSJs. The Sponsoring Firm employs 106 registered representatives, 13 of whom are also registered principals, and 13 other employees. The Firm is engaged in a general securities business and is also a member of the Pacific Stock Exchange.

The Firm has the following disciplinary history, in descending chronological order. In 2005, NASD accepted a Letter of Acceptance, Waiver and Consent ("AWC") from the Firm. The AWC imposed a censure on the Firm; a $5,000 joint and several fine on the Firm and Employee 2, the Firm's FINOP; and a five-day suspension as a principal or supervisor on Employee 2 for: 1) permitting the Firm's president to conduct a securities business while his securities registration was inactive due to failure to satisfy the continuing education requirements; 2) permitting excessive commissions to be charged in 11 agency transactions; and 3) failing timely to report two customer complaints and one customer settlement for two registered representatives.

In May 2005, the State 3 Securities Board reprimanded the Firm and fined it $4,000 for failing to re-establish a designated officer registered with the State 3 Securities Commissioner within 30 days after removing the Firm's previous designated officer.

In 2003, NASD accepted an AWC from the Firm, following a financial operations special examination. NASD fined the Firm and Employee 2 $2,000, jointly and severally, for allowing the Firm's debt-equity ratio to exceed 70 percent for more than 90 days.

In 2003, NASD issued the Sponsoring Firm a Letter of Caution ("LOC") for failing to submit a copy of a response to an information request. The Firm responded to the LOC in 2003.

In 2002, the Firm consented to a fine of $7,500 in an AWC for failing to comply with the reporting requirements of the Order Audit Trail System ("OATS") rules.

IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes that X be permitted to register only as a limited representative-corporate securities representative. It will place restrictive conditions on his employment as follows. X will place orders with the Sponsoring Firm to buy or sell securities for his own brokerage account with the Firm and for the brokerage accounts of his two immediate family members (his wife and stepdaughter), if they grant appropriate trading authority to X and the Firm. In addition, X will introduce potential customers to the Sponsoring Firm who are expected to place orders with the Firm to buy or sell securities for their own accounts solely on an unsolicited basis. X will be listed on the Firm's new account form as the representative who introduced the account, but he will not accept the account on behalf of the

Sponsoring Firm. The Proposed Supervisor 2 and one other principal of the Sponsoring Firm will review each potential brokerage account that X introduces to the Firm. Once the Firm has accepted the account, moreover, X will not perform any of the duties of a registered representative for the account imposed by applicable SEC, NASD, or other securities laws, rules, or regulations. The Firm will assign such responsibilities to another of its qualified representatives. For all accounts except the three family accounts that X trades, the Sponsoring Firm will compensate X solely by an override of the commissions earned by the Firm from unsolicited transactions in securities executed by the Firm for the accounts that X introduces. The Sponsoring Firm has represented that X would receive a maximum override of 50¢ per transaction.

The Sponsoring Firm also proposes that the Proposed Supervisor 2 supervise X at the Firm's main office. The Proposed Supervisor 2 has been a general securities representative since March 1993 and a general securities principal since November 1998. The Firm has employed the Proposed Supervisor 2 as a general securities principal since April 2002, and he currently supervises six registered representatives. The Proposed Supervisor 2 has no disciplinary history.

V. Member Regulation's Recommendation

In a letter dated July 2005, supplemented by a letter dated September 2005, Member Regulation recommended that the NAC deny the Sponsoring Firm's Application to employ X. Member Regulation expressed its concern that the two securities-related offenses that X committed demonstrated a pattern of fraudulent conduct. Further, Member Regulation questioned the Firm's regulatory history and its ability to provide meaningful supervision for X.

VI. Discussion

After carefully reviewing the entire record in this matter, we concur with Member Regulation's recommendation and deny the Sponsoring Firm's Application to employ X as a limited representative-corporate securities representative. We find that it would not be in the public interest to permit X to re-enter the securities business and that his employment in the industry may create an unreasonable risk of harm to the market or investors.[10]

A. The Legal Standards

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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).

As the Commission stated in its 2005 decision remanding this matter, the legal standards that govern our review are set forth in *Van Dusen* and *Ross*.[11] *Van Dusen* provides that in situations where the Commission has already addressed an individual's misconduct through its administrative process and has chosen to impose certain sanctions for that misconduct, NASD should not consider the individual's underlying misconduct when it evaluates a statutory disqualification application. The Commission stated that when the period of time specified in its order has passed, in the absence of "new information reflecting adversely on [the applicant's] ability to function in his proposed employment in a manner consonant with the public interest," it is inconsistent with the remedial purposes of the Exchange Act and unfair to deny an application for re-entry. *Van Dusen*, 47 S.E.C. at 671.

The Commission also noted in *Van Dusen*, however, that an applicant's re-entry is not "automatic" after the expiration of a given time period. Instead, the Commission instructed NASD to consider other factors, such as: 1) other misconduct in which the applicant may have engaged; 2) the nature and disciplinary history of the prospective employer; and 3) the supervision to be accorded the applicant. *Van Dusen*, 47 S.E.C. at 671. Subsequently, in *Ross*, the Commission noted that, if an applicant had engaged in additional misconduct that was similar to the misconduct underlying a bar order in which the time prohibiting application had passed, it was appropriate to consider both instances of misconduct "as forming a significant pattern" which might justify the denial of an application. *Ross*, 50 S.E.C. at 1085 n.10.

B. X's Pattern of Misconduct

First, we consider X's misconduct and look to *Ross* and the Commission's statement that if the cited conduct underlying the statutorily disqualifying event were similar to other misconduct brought to NASD's attention, NASD may consider the former conduct along with the latter as forming a "significant pattern." *Ross*, 50 S.E.C. at 1085. Here, we note that X's 1969 Permanent Injunction resulted from his misconduct as a trader in inserting fictitious quotes in the pink sheets to further a manipulative scheme to create the false appearance of a market for ACI stock. Thus, X's deceptive activities as a trader aided and abetted a market manipulation.

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[11] Subsequently, the Commission extended the rationale of *Van Dusen* to apply to any statutorily disqualified individual whose disqualifying conduct has led the Commission to take administrative action that has resulted in sanctions that are less serious than a bar with the right to reapply. *See Reuben D. Peters,* Exchange Act Rel. No. 49819, 2004 SEC LEXIS 1245, at *16 (June 7, 2004), r*econsideration denied,* Exchange Act Rel. No. 51237, 2005 SEC LEXIS 419 (Feb. 22, 2005) ("Although the administrative sanctions at issue in both *Van Dusen* and *Ross* were conditional bars, nothing in the rationale of those two decisions suggests that the standard set forth therein is not equally applicable to any statutorily disqualified person whose disqualifying conduct has also resulted in administrative sanctions imposed by [the Commission] pursuant to Section 15 of the Exchange Act."); *[CASE REDACTED]*.

X's subsequent 1992 misdemeanor conviction also resulted from his deceptive activities as a trader in parking securities for another firm. These activities caused false entries to be made on that firm's FOCUS report and misrepresented its financial condition. X deceived his employer, circumvented its procedures, and engaged in an act intended to defraud NASD and the public. This activity was described by the State 2 District Attorney in an October 1992 letter to NASD as "a massive stock-rigging scheme in the over-the-counter market."

Twice over a long period of time X engaged in activities that were part of fraudulent schemes designed to mislead the market and investors and further his own personal gain.[12] These incidents constitute a pattern of deceptive conduct that, in our judgment, seriously undermines his integrity and ability to deal fairly with public investors. As the Commission stated in its 1996 decision affirming NASD's decision to deny X permission to re-enter the industry at that time:

> The conviction at issue, while a misdemeanor, reflects poorly on X's integrity. Moreover, the fact that we suspended X, at an

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[12] In remanding this matter to the NAC, the Commission stated that our 2003 decision denying X's re-entry into the securities industry failed to distinguish X's circumstances from those presented in *SD99004*, available at http://www.nasd.com/web/groups/enforcement/documents/nac_stat_dq_decisions/nasdw_011574.pdf, (NAC 1999), where we permitted a two-time-statutorily disqualified individual to re-enter the securities industry. *[CASE REDACTED]*. We first note that each NAC decision is based on the facts and circumstances of the specific case before it. X's securities-related violations, his sponsoring firm, his supervisor, and the quality of his testimony at our hearing are all different from the application in the previous NAC decision in *SD99004*. The Commission has firmly established "that the appropriate remedial action depends on the facts and circumstances of each particular case, and cannot be precisely determined by comparison with action taken in other cases." *See Pacific On-Line Trading & Sec., Inc.*, Exchange Act Rel. No. 48473, 2003 SEC LEXIS 2164, at *20 (Sept. 10, 2003); *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973). Here, we exercise our business judgment in concluding that based on the totality of facts, X should not be permitted to work in the securities business. *See Halpert & Co.*, 50 S.E.C. 420, 422 (1990).

Nevertheless, to address the Commission's stated concern, we note that the pattern that emerges from X's statutorily disqualifying event and his subsequent history of misconduct is one of deceitful misconduct connected to schemes to perpetrate a widespread fraud on the market and investors. Moreover, at the time of each of X's offenses, he was acting as a trader at a securities firm, and he betrayed the trust that was placed in him both by the firms and the public. We find that the Sponsoring Firm has failed to demonstrate its ability to establish and maintain heightened supervisory controls over X. Our conclusion here is the opposite of our finding in *SD990004* that the firm in that case had "addressed satisfactorily" the risks represented by the statutorily disqualified individual's continued association.

> earlier point in his career, from association with a broker or dealer, and obtained an injunction against his committing securities fraud, underscores for us . . . that he lacks the integrity demanded of those working in the securities industry.

[CASE REDACTED].

C. The Nature and Disciplinary History of the Firm

Next, we look to the nature and disciplinary history of the Sponsoring Firm. We stated in our 2003 decision that we had no objection to the regulatory history of the Firm, which then consisted of a 2003 LOC for failing to submit a copy of a response to an information request, and a 2002 AWC imposing a $7,500 fine for failing to comply with the reporting requirements of the OATS rules.

The record now, however, includes evidence of several new actions against the Firm that cause us concern. In 2005, NASD accepted an AWC that resulted from the Firm's permitting its president to conduct a securities business with an inactive securities registration; charging excessive commissions in agency transactions; and failing timely to report two customer complaints and one customer settlement for two registered representatives. In May 2005, the State 3 Board of Securities reprimanded the Firm and fined it $4,000 as a result of the Firm's failure to re-establish a designated officer registered with State 3 after it had removed its previous designated officer. Finally, in 2003, NASD accepted an AWC from the Firm as a result of the Firm's having allowed its debt-equity ratio to exceed the acceptable level.

We find that these recent violations demonstrate the Firm's continuing inability to attend to routine details involved in the ongoing daily management of a securities business. We further find that these violations show a breakdown in the Firm's required daily supervisory and management controls that lead us to conclude that the Firm is not capable of assuming the additional heavy burden of supervising a statutorily disqualified individual such as X. Our conclusion is buttressed by the fact that the Firm, in pursuing its sponsorship of X in this remand proceeding, neglected to inform NASD that it had terminated Proposed Supervisor 1 in June 2005 – the very person proposed as X's supervisor. The Firm's inattention to such a key element of the Application suggests that it may not be able to maintain heightened supervisory controls over X, a person with a history of deceitful misconduct.

D. The Proposed Supervision

Finally, we consider the Firm's proposed supervisory structure for X. We note that the proposed primary supervisor, Proposed Supervisor 2, has been a general securities principal with the Sponsoring Firm since 2002 without incident. Nevertheless, we find that Proposed Supervisor 2's unblemished disciplinary record does not outweigh the very serious disciplinary histories of the Firm and X. As we noted earlier, the Firm's recent history shows that it has been inattentive to internal controls. Accordingly, we have concerns with the Firm's ability to supervise an individual such as X, who has proven in the past that he is capable of engaging in deceitful conduct that escapes the detection of his supervisors.

We are also troubled by the two specific roles that the Firm has outlined for X to play. First, the Firm proposes that X will place orders with the Sponsoring Firm to buy and sell securities for his own brokerage account with the Firm and for the brokerage accounts of his wife and stepdaughter, provided they grant appropriate authority to X and the Firm. We note that X can continue to trade those accounts through various means as a customer as he has testified that he has been doing since 1992, when Firm 2 terminated him due to the parking violation. X need not be associated with a member firm in order to conduct trading in such accounts. Association with a securities firm is a privilege, not a right, and we do not believe that it should be granted merely to accommodate a desire to facilitate personal and family-related trading activities.

Second, the Firm proposes that X will act as a "finder" for the Sponsoring Firm. He will introduce potential customers to the Firm, who will be expected to place orders with the Firm to buy or sell securities for their own accounts. The Sponsoring Firm asserts that X will not accept these accounts on behalf of the Firm or act as the registered representative in charge of these accounts. The Firm does, however, propose that X will receive an override of the commissions earned by the Firm from the unsolicited transactions executed in the accounts he introduces. X does therefore have a financial incentive to find as many of these customers as possible. Given his regulatory history, we are not persuaded that X has the judgment and integrity to be engaged with the public in such a manner.

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 limited representative-corporate 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

LATER CASE HISTORY:

X subsequently appealed this decision to the SEC. In 2006, the SEC dismissed the application for review in this matter. For previous history in this matter, see SD Decision No. 03008.