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 the Association of X as an Investment Company Products/Variable Contracts Representative with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 SD Decision No. 05008 Dated: 2005

On August 2, 2004, the Sponsoring Firm[1]"(“the Firm") completed a Membership Continuance Application ("MC-400" or "the Application") seeking to permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as an investment company products/variable contracts representative. In April 2005, a subcommittee ("Hearing Panel") of NASD's Statutory Disqualification Committee held a hearing on the matter. X appeared in person at the hearing, accompanied by his proposed supervisor, and his counsel, MB. LL and JV appeared on behalf of NASD's Department of Member Regulation ("Member Regulation").

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

A. X's Statutorily Disqualifying Event

X is statutorily disqualified pursuant to Art. III, Sec. 4(f) of NASD's By-Laws because, in 2003, NASD's Department of Enforcement ("Enforcement") accepted his submission of a Letter of Acceptance, Waiver and Consent ("AWC"). NASD suspended X for six months in any capacity and imposed a $7,500 fine. The AWC also specifically provided that:

[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.

> X understands that this settlement includes a finding that . . .
> he willfully failed to disclose a material fact on a Form U-4, and . . .
> he willfully misrepresented a material fact on a Form U-4 amendment,
> and that . . . he is therefore subject to a statutory disqualification
> with respect to association with a member.

In the AWC, X consented to NASD's finding that, in October 1999, he willfully failed to disclose material facts on a Uniform Application for Securities Industry Registration or Transfer ("Form U4") filed on his behalf by his former securities industry employer, Firm 1. The material facts at issue were that: 1) in September 1987, the United States Attorney's Office for State 1 charged X with two felony counts of filing false federal income tax returns; and 2) in September 1987, X pleaded guilty to one felony count of filing a false federal income tax return.[2] X also consented in the AWC to NASD's finding that in April 2000, he misrepresented on an amended Form U4 that he submitted to Firm 1 that these criminal charges and his guilty plea involved a misdemeanor, when he knew, or should have known, that they involved a felony.

B. Background Information

1) X

X first registered in the securities industry with Firm 1 as an investment company products/variable contracts representative (Series 6) in March 2000. He also passed qualifying examinations for uniform securities agent state law (Series 63) in March 2000, general securities representative (Series 7) in September 2001, and uniform investment advisor (Series 65) in November 2001. Firm 1 employed X from January 2000 until January 2003, when it discharged him for violating company policies relating to correspondence and seminar review.[3]

Prior to that time, X had been employed in the aerospace defense industry. In 1978, he founded a company named Firm 2 that acted as an engineering specialist and a manufacturer's representative and distributor specializing in process control and factory automation equipment. X sold certain of his Firm 2 interests in 1998 and began working in the insurance industry. X

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[2] On his 1981 federal income tax return, X reported taxable personal income of $15,061, instead of the true amount, which was $48,879. This misconduct ceased to be a statutorily disqualifying offense in September 1997, which was 10 years after the date that X pleaded guilty and was convicted of the felony. *See* Art. III, Secs. 4(g)(1)(i) and 4(g)(2), NASD By-Laws.

[3] According to the Uniform Termination Notice for Securities Industry Registration ("Form U5") and X's testimony at the hearing, Firm 1 placed X under heightened supervisory conditions in December 2001, after it became aware of NASD's investigation into the circumstances underlying the AWC. X violated certain of those conditions when he failed to submit written materials to Firm 1 prior to conducting seminars, and therefore Firm 1 terminated him.

testified that he primarily sold insurance products in State 1, his state of residence, although he filed applications to be permitted to sell insurance in several other states. More details about these insurance applications are provided below in Part E.

The record shows no customer complaints or other disciplinary or regulatory actions against X.

2) The Firm

The Sponsoring Firm became an NASD member in 1994. The Firm has only one office – its home office in State 2. It employs one registered principal and two registered representatives. It is engaged in retail sales of mutual funds and acts as a broker or dealer selling variable life insurance and annuities.

NASD's last two routine examinations of the Firm resulted in a finding of Filed Without Action in 1999, and a Letter of Caution ("LOC") in 2003. NASD issued the 2003 LOC to the Firm for failing to have written supervisory procedures addressing continuing education; allowing an individual to become inactive due to failure to comply with continuing education requirements; and failing to file a Form U5 within 30 days of an individual's termination.

The record shows no other disciplinary or regulatory actions against the Sponsoring Firm.

C. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes to employ X as an investment company products/variable contracts representative in its home office in State 2. The Firm will compensate him solely through commissions.

The Firm also proposes that the Sponsoring Firm will be X's primary responsible supervisor. The Proposed Supervisor is the President of the Sponsoring Firm, and he has been with the Firm since its inception in August 1994. The Proposed Supervisor has been employed in the securities industry since 1973, having qualified as a general securities representative (Series 7) in October 1973, and as an investment company products/variable contracts principal (Series 26) in May 1987 and October 1994.

The record shows no disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

D. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied, primarily because X's actions in repeatedly failing properly to report his felony charge and felony conviction "create a troubling trail of serious dishonest misconduct."

E. Discussion

After carefully reviewing the entire record in this matter, including the briefs submitted by the parties subsequent to the hearing,[4] we concur with Member Regulation's recommendation and deny the Sponsoring Firm's Application to employ X as an investment company products/variable contracts representative.[5]

1) The Commission's Van Dusen Decision is Not Applicable

In reaching this conclusion, we have considered and rejected X's argument that our analysis in this matter is governed by the Securities and Exchange Commission's line of decisions beginning with *Paul Edward Van Dusen*, 47 S.E.C. 668 (1981). *Van Dusen* enunciated the standards for NASD to apply in situations in which an individual is applying to re-enter the securities industry after previously having been subject to a permanent injunction and a bar by the Commission, with a right to reapply.[6] In such situations, the Commission advised that, because it had already addressed the individual's misconduct through its administrative process and had chosen to impose certain sanctions for that misconduct, NASD should not again consider the individual's underlying misconduct when it evaluates a statutory disqualification application. The Commission stated that such applications for re-entry generally should be acted upon favorably, and that NASD should look only to: 1) whether the individual had engaged in intervening misconduct; 2) whether the prospective employer had any disciplinary history, and, if so, the nature of that disciplinary history; and 3) whether the supervisory structure proposed for the applicant was sufficient.

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[4] At the conclusion of the hearing, the Hearing Panel granted the Firm's request to submit a brief addressing certain Securities and Exchange Commission decisions that it claimed were supportive of its position that X should be permitted to return to the securities industry. The Hearing Panel also permitted Member Regulation to file a brief in response.

[5] 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).

[6] Subsequently, in *Reuben D. Peters*, Exchange Act Rel. No. 49819, 2004 SEC LEXIS 1245 (June 7, 2004), *reconsideration denied*, Exchange Act Rel. No. 51237, 2005 SEC LEXIS 419 (Feb. 22, 2005), and *Morton Kantrowitz*, Exchange Act Rel. No. 51238, 2005 SEC LEXIS 423 (Feb. 22, 2005), 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.

The *Van Dusen* analysis is limited, however, to matters involving an injunction and an accompanying administrative order by the Commission with regard to the underlying statutorily disqualifying misconduct. Here, NASD's Department of Enforcement – not the Commission – was the entity that took action on the misrepresentations contained in X's Form U4 and amended Form U4 with Firm 1. Enforcement negotiated the AWC with X and had the option of proceeding with the action as a non-willful action, with no statutory disqualification consequences. Enforcement determined, however, to include a specific finding that X had engaged in willful misconduct when he placed the false information on the Form U4 in October 1999 and on the amended Form U4 in May 2000. Enforcement also included in the AWC the precise language that "X understands that this settlement includes a finding that . . . he willfully failed to disclose a material fact . . . and . . . he willfully misrepresented a material fact . . . and that . . . he is therefore subject to a statutory disqualification." The AWC evidences the agreement of the parties that X would be subject to the full process ordinarily applied by NASD to statutorily disqualified individuals, which includes: 1) consideration of the nature and gravity of the disqualifying event; 2) the length of time that has elapsed since the disqualifying event; 3) any intervening misconduct; 4) other disciplinary history; 5) any other mitigating or aggravating circumstances that exist; 6) the precise nature of the securities-related activities proposed in the application; and 7) the disciplinary history and industry experience of both the member firm and the proposed supervisor.

X admitted at the hearing that he had been represented by counsel during his negotiations with Enforcement and that he read and signed the AWC that contained the language stating that he was subject to a statutory disqualification. Accordingly, we conclude that the restrictive analysis of *Van Dusen* does not apply in this matter and that we must consider all of the factors concerning X's statutory disqualification, including the events that led to the November 2003 AWC and any other conduct prior to that date that might shed light on X's fitness to re-enter the securities industry.

2) It is Not Punitive to Consider X's AWC in Assessing the Sponsoring Firm's Statutory Disqualification Application

We also reject X's argument that we are "punishing" him a second time by considering his AWC and the events leading to it in assessing the Application. Statutory disqualification cases are not the same as disciplinary cases. The Commission has defined a disciplinary action as "an action that responds to an alleged violation of an SRO rule or Commission statute or rule, or an action in which a punishment or sanction is sought or intended." *Russell A. Simpson*, 53 S.E.C. 1042, 1046 (1998). In contrast, a statutory disqualification proceeding is not a disciplinary action – with an attendant sanction – but is a process that allows a disqualified person to seek to associate with an NASD member firm in spite of the disqualification.

In a statutory disqualification proceeding, NASD makes no determination that a statutorily disqualified individual has violated any rule. There is no adjudication of liability. NASD neither seeks nor intends punishment by denying an individual's re-entry into the securities industry. In the context of a statutory disqualification case, the Commission has recognized that "NASD has not expelled [a statutorily disqualified person] from the securities industry. Nor is it imposing a penalty on [an] applicant . . . or even a remedial sanction."

Halpert & Co., 50 S.E.C. 420, 422 (1990); *see also Frank Kufrovich*, Exchange Act Rel. No. 45437, 2002 SEC LEXIS 357, at *23 (Feb. 13, 2002) (finding that NASD had not imposed a penalty but had "simply determined that it would not grant relief from a disqualification previously incurred"); *Dennis Milewitz*, 53 S.E.C. 701, 706 (1998) (finding that NASD's decision to deny a statutorily disqualified applicant's request to re-enter the securities industry "does not constitute an additional penalty, or even a remedial sanction").

We therefore conclude that it is appropriate for us to consider all relevant evidence in evaluating the Sponsoring Firm's Application.

3) An Analysis of All Relevant Factors Leads to the Denial of the Sponsoring Firm's Application

Our analysis of the entire record in this matter leads us to deny the Sponsoring Firm's Application to allow X to re-enter the securities industry at this time as an investment company products/variable contracts representative.

In reviewing this type of application, we have considered whether the particular misconduct at issue, examined in light of the circumstances related to the misconduct and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.[7]

There are several factors that compel our decision. First, we conclude that the record raises serious questions as to X's integrity. One of NASD's primary purposes is to promote a "high standard of business ethics" in "every facet of the securities industry." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315 (1985); *see also Citadel Sec. Corp*., Exchange Act Rel. No. 49666, 2004 LEXIS 49666, at *12 (May 7, 2004) (upholding NASD's denial of a statutory disqualification application and finding that a purpose of the Securities Exchange Act of 1934 was "ensuring the integrity of the securities industry"). As the Commission has noted, the securities industry presents many opportunities for abuse and overreaching and depends heavily upon the integrity of its participants. *Halpert & Co*., 50 S.E.C. 420, 422 (1990) (stating that the securities industry is a "field that is rife with opportunities for abuse"). X's initial wrongdoing – filing a false federal income tax return for 1981– was financially related and involved deceitful misconduct. In 1987, X pleaded guilty to a felony for that misconduct.

Moreover, X's subsequent actions cause us to further question X's honesty. When X first entered the securities industry in October 1999 with Firm 1, he falsely represented on the Form

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[7] *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).

U4 that he had never been charged with, or convicted of, a felony or a misdemeanor. When X was given the opportunity to correct this mistake in an amended Form U4 filing with Firm 1 in May 2000, he falsely represented that he had been charged with, and convicted of, a misdeameanor. Enforcement investigated X's misconduct and determined that his failure to disclose his felony charge and conviction was willful. The AWC's finding that X acted willfully means that X knew, or reasonably should have known under the particular facts and circumstances, that his conduct was improper – that he was required to make the disclosures and failed to do so. *Christopher LaPorte*, Exchange Act Rel. No. 39171, 1997 SEC LEXIS 2058, at *8 (Sept. 30, 1997). X consented to the AWC that contained these findings.

The record further demonstrates that at the same time that X was filing false Form U4 information with securities regulators, he was also making misrepresentations in numerous applications for insurance registration. In September 1999, X replied "No" in a New York insurance registration application that asked if he had "ever been convicted in any criminal action." In October 1999, he answered "No" in an application with an insurance company that asked if he had "ever been convicted of a felony, misdemeanor, DWI, etc." In February 2000, he replied "No" on a Connecticut application for insurance registration that asked if he had "ever been convicted of or pled nolo contendere (no contest) to any felony or misdemeanor involving dishonesty or breach of trust." In August 2000, he answered "No" when asked in a State 3 insurance registration application whether he had "ever been convicted, found guilty, or pleaded guilty or nolo contendere (no contest) to a felony" or "to a crime punishable by imprisonment of one (1) year or more." Both State 3 and State 2 insurance regulators took action against X for these misrepresentations. In February 2002, State 3 placed him on probation for one year and fined him $1,500; in July 2002, State 2 fined him $500.

During this period when X was routinely answering "No" to questions about his criminal past, however, he answered "Yes" in January 2000 in a State 1 insurance application that asked if he had "been indicted or convicted of a crime, or convicted of a misdemeanor." X had no credible explanation for the discrepancy in his answers to these applications. At various times, he offered that he had been confused by the different language contained in each application, had "blocked" all thoughts about his conviction from his mind, had not appreciated the importance of full disclosure on licensing applications in a regulated profession, and had been unable to reach his former attorney (who was deceased) or one of his associates to determine whether the 1987 false tax return offense had been a felony or a misdemeanor. We conclude, however, that it is suspect for X to have answered correctly only on the State 1 application, given that he had been convicted by a federal court in that state, resided there, and did most of his insurance business there.

We are also troubled by X's continuing inability to acknowledge his history of misrepresenting facts about his background to regulators. When asked by the Hearing Panel how many times he had incorrectly failed to admit to his felony conviction, X replied "Three times. State 3, State 2, and NASD." X did not admit, until specifically questioned by Member Regulation, that he had also supplied false information on an October 1999 application with an insurance company and on a February 2000 insurance registration application with State 4.

In addition to X's propensity for misrepresenting his past, we are concerned that he has also demonstrated an inability to act responsibly and comply with established rules and regulations. In December 2001, Firm 1 initiated an internal review and placed X on "special supervision" when it discovered that NASD was investigating him for the Form U4 violations that led to the November 2003 AWC. In January 2003, Firm 1 terminated X for failing to follow "certain firm policies in regard to correspondence review and seminar review." A statutorily disqualified person must comply not only with the standard supervisory policies of his or her firm, but with heightened supervisory conditions as well. X's failure to comply with Firm 1's "special supervision" indicates that he may not be able to comply with heightened supervisory conditions placed on him if he were to be permitted to associate with the Sponsoring Firm.

Finally, X's disqualifying event – the November 2003 AWC – occurred very recently. The Sponsoring Firm has the burden of demonstrating to us why it is in the public interest for X to become employed with the Sponsoring Firm. *See Gershon Tannenbaum*, 50 S.E.C. 1138, 1140 (1992) (in eligibility proceedings, burden is on applicants to demonstrate that association is in public interest); *M.J. Coen*, 47 S.E.C. 558, 561 (1981) ("[A]ny member wishing to employ such a [statutorily disqualified] person . . . must 'demonstrate why the application should be granted.'"). We have examined all the evidence presented in this matter and we find that the Sponsoring Firm has not demonstrated that X is willing and able to operate responsibly in the securities industry at this time.

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 an investment company products/variable contracts 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. The SEC remanded the matter back to NASD's NAC, where the matter is currently pending.