

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

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| In the Matter of | Redacted Decision |
| X | <u>Notice Pursuant to</u> <u>Rule 19h-1</u> <u>Securities Exchange Act</u> <u>of 1934</u> |
| as a | |
| General Securities Representative | <u>Decision No. SD05007</u> |
| with | Dated: 2005 |
| The Sponsoring Firm | |

On September 28, 2004, the Sponsoring Firm¹ (“the Firm”) completed a Membership Continuance Application (“MC-400” or “the Application”) seeking to permit X, a person subject to a statutory disqualification, to continue to associate with the Sponsoring Firm as a general securities representative. In March 2005, a subcommittee (“Hearing Panel”) of NASD’s Statutory Disqualification Committee held a hearing on the matter. X appeared, accompanied by his proposed supervisor at the Sponsoring Firm. Employee 1, Assistant Counsel for the Sponsoring Firm, appeared by telephone. LL and JV appeared on behalf of NASD’s Department of Member Regulation (“Member Regulation”).

After carefully reviewing the entire record in this matter, we approve the Firm’s Application to employ X as a registered representative.

A. X’s Statutorily Disqualifying Event

X is subject to a statutory disqualification because in March 2004, he was convicted of Endangerment, a felony in State 1. X was also convicted of the misdemeanor charge of Driving Under the Extreme Influence. X was charged with Endangerment because, in September 2003, he drove his car in violation of a previous restriction on his driver’s license,² while under the influence of alcohol, and while driving a passenger (his wife). X was sentenced to three years’ probation, the terms of which included six months’ incarceration that X was allowed to complete

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 X represents that, in June 2003, he was cited for driving under the influence of alcohol and that his driver’s license was restricted for 30 days to driving for work purposes only.

in a work furlough program and a requirement that X not drink any alcoholic beverage. X also was ordered to pay restitution, fines, and fees related to his arrest and conviction. X's probation will expire in July 2007.

B. Background Information

1. X

X was first qualified as an investment company products/variable contracts representative (Series 6) in April 1984. Since August 2001, X has been associated with the Sponsoring Firm, a member firm, and with Firm A, a registered investment adviser. X qualified to act as a uniform securities state law agent (Series 63) and as a direct participation programs representative (Series 22) in November 1984; as a general securities representative (Series 7) in December 1986; as a general securities principal (Series 24) in February 1995; and as a uniform combined state law agent (Series 66) in May 2002.

From 1984 through August 2001, X associated with several other firms, including member firms. With the apparent exception of a late update to his Uniform Application for Securities Industry Registration or Transfer ("Form U4"), which is described below, X has no disciplinary history.

2. The Firm

a. General Information

The Sponsoring Firm is based in State 1 and has been an NASD member since May 1989. The Firm has 472 branch offices and 418 Offices of Supervisory Jurisdiction ("OSJ"). It employs 457 registered principals and 1,998 registered representatives. The Sponsoring Firm employs its representatives as independent contractors.

The Sponsoring Firm engages in a general securities business, involving a number of types of business activities. The Firm does not employ any statutorily disqualified individuals, and it is not a member of any other self-regulatory organization.

b. Sponsoring Firm's Regulatory History

i. NASD Regulatory History

In 2004, NASD's Department of Enforcement ("Enforcement") accepted a Letter of Acceptance, Waiver and Consent ("AWC") submitted by the Firm. The Firm consented to findings that, from January 2002 through March 2004, it failed to file in a timely manner certain amendments to Forms U4, and that the Firm's supervisory system and procedures were not reasonably designed to achieve compliance with its reporting obligations. The Firm was censured, fined \$100,000, and ordered to comply with certain undertakings related to Article V Reporting.

In 2004, NASD accepted an AWC submitted by the Firm. The Firm consented to findings that, from 1997 through 1999, it failed and neglected to establish, maintain, and enforce adequate written supervisory procedures governing the review of transactions in which branch managers dealt directly with customers. Although the Firm's procedures called for an independent principal review of transactions effected by branch managers, the procedure was not adequately documented or properly communicated to branch managers. The Firm was censured and fined \$35,000.

In 2004, NASD issued the Firm a Letter of Caution ("LOC") after a routine examination completed in December 2002. In the LOC, the Firm was cited for failing to provide appropriate discounts with respect to the sale of mutual fund shares.

In 2004, NASD accepted an AWC submitted by the Firm, in which the Firm consented to findings that: (1) it failed to report timely to the Trade Reporting and Compliance Engine ("TRACE") 370 transactions in TRACE eligible securities; and (2) it improperly reported to TRACE 154 transactions as new trades. The Firm was censured and fined \$7,500.

In 2004, Enforcement accepted an AWC submitted by the Firm, in which it consented to findings that: (1) the Firm, acting through an associated person, made unsuitable recommendations of Class B mutual fund shares to 12 customers; and (2) the Firm failed to establish, maintain, and enforce adequate written supervisory procedures and a supervisory system reasonably designed to detect and prevent unsuitably large purchases of Class B mutual fund shares. The Firm consented to a censure, a fine of \$75,000, a cash settlement of \$105,769.86 paid to customers, an obligation to establish procedures relevant to the recommendation and sales of Class B mutual fund shares, and an obligation to require that its representatives and principals complete a training program regarding recommending Class B mutual fund shares. The associated person was fined \$5,000, suspended for 30 days from associating with any member in any capacity, ordered to requalify as an investment company and variable contracts representative, and ordered to disgorge to customers \$39,000.

The Firm's 2003 routine examination resulted in an LOC. NASD cited the Firm for violating various rules, including books and recordkeeping requirements, registration requirements, continuing education requirements, and supervisory requirements.

The Firm's 2002 routine examination also resulted in the issuance of an LOC. NASD cited the Firm because correspondence from, and sales literature used by, two associated persons were not reviewed and approved by a principal or a supervisory qualified designee.

The 2000 routine examination of the Firm resulted in the submission of an AWC, which Enforcement accepted in 2001. NASD cited the Firm for: (1) failing to report a number of customer complaints, terminations for cause, and other matters during various periods in 1999 and 2000; (2) failing to amend Forms U4 and Uniform Termination Notices for Securities Industry Registration ("Form U5") for registered representatives; (3) failing to completely respond to the District Offices' requests for information; and (4) failing to have written supervisory procedures that were reasonably designed to ensure that the Firm complied with its obligations to amend promptly Forms U4 and U5. The Firm was censured and fined \$75,000.

NASD has commenced, but not completed, its 2005 routine examination of the Firm.

ii. State Regulatory Actions

In August 2002, the State 2 Department of Finance, Securities Bureau found that the Firm failed to enforce procedures pertaining to the activities of a registered representative. The action was resolved with the filing of an order by the state. The Firm was ordered to refund \$651.91 to a customer and agreed to pay \$2,500 to the State 2 Department of Finance for investigation costs that were incurred.

In May 1996, the Firm settled charges brought by the State 3 Bureau of Securities Regulation alleging that the Firm had violated state recordkeeping requirements. The Firm agreed to pay a \$2,500 fine and to perform compliance examinations related to the violation.

iii. Pending Actions

In its MC-400, the Firm states that it is currently involved in litigation with its former clearing house, Firm B. Member Regulation represents that the dispute is not customer-related.

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

C. X's Proposed Business Activities and Supervision

The Firm represents that X will be employed as a registered representative, that he will provide financial planning services to an "existing book of business and to a referral base of clients," and that his new clients will come "solely through referrals." The Firm represents that X will be compensated solely on a commission basis.

The Firm proposes that the Proposed Supervisor be responsible for supervising X. The Proposed Supervisor first registered in the securities industry as a direct participation programs representative (Series 22) in April 1988. The Proposed Supervisor has been associated with the Sponsoring Firm since September 2004 and is registered as a general securities representative, a general securities principal, an investment company products/variable contracts representative, and a direct participation programs representative. The Proposed Supervisor testified that he is the manager of his Sponsoring Firm OSJ, overseeing 11 representatives. The Proposed Supervisor also is associated with Firm A, a registered investment adviser. The Proposed Supervisor qualified as an investment company products/variable contracts representative (Series 6) and a uniform securities state law agent (Series 63) in May 1988; as a general securities representative (Series 7) in January 1992, and as a general securities principal (Series 24) in January 1996. In January 2005, the Proposed Supervisor passed the North American Securities Administrators Association (NASAA) Uniform Combined State Law Exam (Series 66). Prior to

his association with the Sponsoring Firm, he associated with another member firm for 16 years. The Proposed Supervisor has no formal or informal disciplinary history.³

The Firm represents that the Proposed Supervisor will be located in the same office as X, and will work in close proximity to X's work area. There is conflicting evidence concerning the number of persons whom the Proposed Supervisor currently supervises: in a letter to Member Regulation, Employee 1 represented that the Proposed Supervisor supervises two registered representatives, but the Proposed Supervisor testified that he supervises 10 or 11 persons.

D. Member Regulation Recommendation

Member Regulation recommends that the Firm's application be approved.

E. Discussion

In reviewing this type of application, NASD considers whether the particular felony at issue, examined in light of the circumstances related to the felony and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.⁴ For the reasons set forth below, we conclude that X's association with the Sponsoring Firm as a general securities representative, with the proposed plan of supervision, does not present an unreasonable risk of harm to the market or investors.⁵

X's disqualifying event was serious. X's punishment by the State 1 legal system was severe. He was imprisoned for six months and subjected to three years' probation, a term that has not yet expired. We focus our analysis, however, on whether X's association presents a risk of future harm to investors or the markets. We find that it does not.

³ In March 2005, the Sponsoring Firm amended its application to substitute the Proposed Supervisor as X's proposed supervisor in place of another individual. We have added to the record the Central Registration Depository ("CRD[®]") snapshot record for the Proposed Supervisor.

⁴ See *Frank Kufrovich*, Exchange Act Rel. No. 45437, 2002 SEC LEXIS 357 (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 basis for its conclusion that the applicant would present an unreasonable risk of harm to the market or investors).

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).

Until his felony conviction, X had been employed in the securities industry for nearly 20 years with no disciplinary or regulatory problems. The felony conviction did not involve securities or financial products, nor did the court find that X acted dishonestly. Furthermore, X has no intervening criminal misconduct, has complied with all terms of his probation, and has accepted responsibility for his actions. Significantly, X has taken appropriate measures to address the problems that led to his felony conviction, including attending and completing 36 hours of substance abuse counseling, installing an ignition override device on his vehicle, and attending traffic survival school. In addition, from September 2003 to July 2004, X was enrolled in a pre-trial drug testing program and all tests were negative. We also find that X has made significant efforts to maintain the same level of service to his clients notwithstanding the restrictions on his driver's license, by conducting more appointments in his office and by arranging for his spouse to drive him to meetings outside the office.

It is of some concern that X did not disclose on his Form U4 either the September 2003 felony charge or his March 2004 conviction until August 2004. While we credit X's explanation that he mistakenly believed disclosure was not required until after he was sentenced in July 2004, even under that mistaken belief, his disclosure of his felony conviction was 23 days late. *See* NASD By-Laws, Art. V, Sec. 2(c) (requiring registered representatives to update Forms U4 not later than 10 days after an event giving rise to a disqualification). Nevertheless, an untimely disclosure is less serious than a complete failure to disclose, and X frankly admitted his mistake, expressed his regret for his delay, and explained that he has paid a fine for his tardiness. Given these circumstances, and that the Sponsoring Firm recently has taken corrective action to prevent late amendments to Forms U4 and U5, we think it is unlikely that this isolated event of securities-related misconduct is indicative of an unreasonable risk of harm to the market or investors.

In light of the large size and structure of the Sponsoring Firm, its disciplinary history is not of such a nature that would cause us to deny this application. In this regard, X's 20 years of experience in the securities industry, his lack of any significant regulatory disciplinary history, his long-lasting relationships with generations of clients, and the fact that he explained to his clients the circumstances of his criminal history, demonstrates that he fully understands his professional responsibilities to his customers. In addition, there is no formal or informal regulatory history for the Proposed Supervisor. The Firm also has agreed to heightened supervisory terms and conditions to ensure that X will continue to present no risk to the market or investors.

Given the nature of X's felony offense and the fact that he has had a long and successful career in the securities industry prior to his disqualification, 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:⁶

⁶ Those supervisory terms and conditions marked with an asterisk (*) are special for X and not required of all the Sponsoring Firm registered representatives.

1. The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;
2. X will be supervised on-site by the Proposed Supervisor, and he will be seated in close proximity to the Proposed Supervisor;
3. X will not maintain discretionary accounts;
4. X will not act in a supervisory capacity;
5. The Proposed Supervisor will review all of X's new account forms for the various products that he is permitted to sell. The Proposed Supervisor will approve all new accounts, and he will evidence his approval by initialing the account paperwork;
6. The Proposed Supervisor will review X's outgoing and incoming written correspondence at the time they are either sent or received. No correspondence will be sent or received without the Proposed Supervisors' review and approval;
7. The Proposed Supervisor will initial all of X's prospective case files on a weekly basis;
8. *The Regional Management Department will conduct a telephone conversation with X on a monthly basis, for a period of one year, to discuss X's workload and confirm that he is compliant with the heightened plan of supervision;
9. The Firm will monitor X's activities through its Transaction Review system;
10. All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the Compliance Department. The Proposed Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. The Proposed Supervisor will keep all documents pertaining to these complaints segregated for ease of review;
11. The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Compliance Department of the Sponsoring Firm that X and the Proposed Supervisor are in compliance with all of the above conditions of heightened supervision to be accorded X; and

12. For the duration of X's statutory disqualification, the Sponsoring Firm must obtain prior approval from Member Regulation if it wishes to change X's supervisor from the Proposed Supervisor to another person.⁷

NASD certifies that X meets all applicable requirements for the proposed employment, that the Firm is not a member of any other self-regulatory organization, and that X and the Proposed Supervisor have represented that they are not related by blood or marriage.

Accordingly, we approve X as a registered representative with the Sponsoring Firm. In conformity with the provisions of SEC Rule 19h-1, the association of X 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

⁷ Both the Sponsoring Firm and Member Regulation also recommended that X not be permitted to conduct unsupervised face-to-face contact with customers for a period of one year and that the Proposed Supervisor be required to attend all of X's interviews, appointments, or meetings wherever they take place, conditions to which the Sponsoring Firm consented. While we are impressed with the vigor of the proposed supervisory plan, we do not think that such restrictions are needed to protect investors, and we have modified the required conditions accordingly. Of course, if the Firm wishes to impose more rigorous supervisory conditions, that option is available to it.