

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 <u>Notice Pursuant to</u> <u>Rule 19h-1</u> <u>Securities Exchange Act</u> <u>of 1934</u> <u>Decision No. SD05009</u> Dated: 2005
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On September 21, 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 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, MW. LL and JV appeared on behalf of NASD's Department of Member Regulation ("Member Regulation"). For the reasons explained below, we approve the Sponsoring Firm's application.

A. X's Statutorily Disqualifying Event

X is statutorily disqualified because, in July 1998, he pleaded guilty in the United States District Court for the Northern District of State 1 to making and subscribing a false tax return, a felony under federal criminal statutes. X made the false statement in connection with the filing of his federal income tax return for the tax year ended December 31, 1991. X claimed \$177,916 in business expenses, when he had never paid the expenses. The court sentenced him to five years' probation, required him to serve 180 days' home confinement (he was allowed to leave home only for employment purposes), and ordered him to pay a \$3,000 fine and \$214,064 in

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.

restitution to the Internal Revenue Service. The probation was discharged early, after only three years, in November 2001, and X has represented that he has paid all fines, costs, and restitution.

B. Background Information

1) X

X began his financial services career as a life insurance agent in 1980. He first registered in the securities industry as an investment company products/variable contracts representative (Series 6) in August 1996. He requalified for the Series 6 in September 2003. X was employed at Firm One from July 1996 to August 1997. (The federal charges were initiated against X in June 1997). In September, 2003, X applied to be associated with Firm Two, but Firm Two withdrew its MC-400 Application for him in February, 2004.² Since December 1998, X has been employed as an independent contractor, selling insurance products.³ 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 August 1995. The Firm has three branch offices and one office of supervisory jurisdiction ("OSJ"), which is its home office in State 2. It employs 183 registered principals, 780 registered representatives, and 12 other employees. The Firm engages primarily in wholesale activities of variable products used in implementing qualified and nonqualified corporate plans such as deferred compensation programs and the retail sales of investment company securities and 529 plans.

The Firm's last two routine examinations resulted in the issuance of one Letter of Caution ("LOC") and one Letter of Acceptance, Waiver and Consent ("AWC"). NASD issued an LOC to the Firm following the 2000 routine examination for failing to obtain prior approval from NASD before opening several branch offices; having improper written supervisory procedures for issues relevant to the purchases of Class B mutual fund shares; failing to amend Uniform Applications for Securities Industry Registration or Transfer ("Forms U4") and Uniform Termination Notices for Securities Industry Registration ("Forms U5"); and failing to timely file two FOCUS Reports. The Firm consented to an AWC after the 2004 routine examination for failing to develop and implement a written anti-money laundering program. NASD censured the Firm and fined it \$10,000.

² X stated at the hearing that Firm Two was in the initial process of becoming a public company and determined that it was not in its best interest at that time to sponsor any statutory disqualification applications.

³ After his 1998 felony conviction, X voluntarily sought and received permission from the State 1 Department of Insurance to continue to operate as an insurance agent.

Following an alternative municipal examination in 2002, NASD issued the Firm an LOC for failing to receive written approval prior to engaging in a new line of business; failing to have written supervisory procedures for municipal securities activities; and failing to amend its Uniform Application for Broker-Dealer Registration ("Form BD") to indicate that it had become a municipal securities broker.

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, which is also an OSJ, in State 2. He will be compensated solely through commissions. X will be engaged primarily in the design and implementation of qualified and nonqualified corporate plans utilizing variable and universal life insurance contracts.

The Firm also proposes that the Proposed Supervisor serve as X's primary, responsible supervisor. The Proposed Supervisor started the Sponsoring Firm in 1994, and he is the Firm's President. He was first registered in the securities industry as an investment company products/variable contracts representative in September 1980. He became a general securities principal (Series 24) in July 1989. The Proposed Supervisor will not be directly responsible for supervising any other registered representatives.

The Proposed Supervisor was named as a principal in a 1997 NASD decision against one of his prior firms for charging unreasonable commissions of eight percent for the sales of eight Direct Participation Programs on the secondary market. The National Business Conduct Committee (the predecessor committee to the NAC) ordered its decision in that case to serve as a Letter of Caution. The Proposed Supervisor has no other disciplinary history.

D. 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.

E. Discussion

After carefully reviewing the entire record in this matter, we approve the Sponsoring Firm's Application to employ X as an investment company products/variable contracts representative, subject to the supervisory terms and conditions set forth below.⁴

⁴ Pursuant to NASD Procedural Rule 9524(a)(10), the Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. In turn, the Statutory

[Footnote continued on next page]

In reviewing this type of application, we have considered 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.⁵ We acknowledge that X's statutorily disqualifying event involved dishonest conduct and was financially related. We also note, however, that the actual misconduct occurred more than 10 years ago and appears to have been an aberration on X's regulatory slate that has otherwise been unblemished since he first entered the insurance industry in 1980.⁶ We further note that the federal judge who sentenced X recognized that he had taken responsibility for his misconduct and had also given "substantial assistance" to federal prosecutors in a separate civil tax action. The judge therefore sentenced X to a sentence less than that recommended by the Federal Sentencing Guidelines. X's five-year probation was also terminated in November 2001, after he served only three years, and he has not engaged in any intervening misconduct. Moreover, X has been totally forthcoming in his disclosures to insurance and securities regulators regarding his statutory disqualification. Having had the opportunity to assess X's demeanor during his testimony and his record in the industry, we believe that he does not pose a threat to the investing public and that his other conduct before and after his conviction does not reflect a pattern of dishonesty.

Further, the Proposed Supervisor, has been in the securities industry for 25 years and is well qualified. Similarly, the Firm has been an NASD member since 1995, and it has agreed to a comprehensive supervisory plan to ensure that it will be able to maintain future compliance with the plan of heightened supervision for X. Although both the Proposed Supervisor and the Firm have some disciplinary history, we are not concerned that this history will have an impact on their ability to supervise X in his proposed role at the Firm.

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Disqualification Committee considered the Hearing Panel's recommendation and presented a written recommendation to the NAC, in accordance with Procedural Rule 9524(b)(1).

⁵ 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).

⁶ X testified at the hearing as to the circumstances that existed at the time of his misconduct. He accepted full responsibility for his wrong decisions, but explained that he had been struggling to keep afloat a former employer insurance company that he purchased when his friend, the company's president, became ill and died. X stated that he had to leverage the purchase and only did so because he could not find another buyer who would continue the business and maintain the staff. X later sold that business in 1998 to a company that did not relocate the work force.

Accordingly, we believe that permitting X to be employed as an investment company/variable products representative with the Sponsoring Firm poses no threat to the public interest and does not create an unreasonable risk of harm to the market or investors.

In approving this Application, we impose the following specific supervisory procedures and operating restrictions on the Sponsoring Firm, the Proposed Supervisor, and X:⁷

1. * The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;
2. * The Proposed Supervisor will be seated in close proximity to X and will supervise him on-site;
3. X will not maintain discretionary accounts;
4. * X will not act in a supervisory capacity;
5. * The Proposed Supervisor will review all applications handled by X for suitability and will evidence his review by initialing the applications;
6. * The Proposed Supervisor will approve all illustrations, presentations and correspondence prepared by X and will evidence his approval by initialing any relevant paperwork;
7. * The Proposed Supervisor will review X's transaction blotters on a bi-weekly basis to ascertain that all transactions were approved and will evidence his review by initialing the transaction blotters;
8. * The Proposed Supervisor will meet with X on a bi-weekly basis to review his conduct and transactions and will evidence these reviews on the blotter;
9. X will not accept customer funds in his name. All funds must be payable to the particular insurance carrier;
10. 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 Supervisor's review and approval;

⁷ The Firm has indicated that those supervisory terms and conditions denoted with an asterisk (*) are special for X and are not required of the Firm's other registered representatives.

11. 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;
12. * 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; and
13. * 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.

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) X and the Proposed Supervisor have represented that they are not related by blood or marriage; and 4) the Firm does not currently employ any other individuals who are subject to a statutory disqualification.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the association of X as an investment company products/variable contracts representative with the Sponsoring Firm will become effective within 30 days of the Commission's receipt of this notice, unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney, Senior Vice President and
Corporate Secretary