

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Association of X as an Investment Company/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. SD04013</u> Date: 2004
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On June 23, 2003, 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/variable contracts representative. In April 2004, 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 the Proposed Supervisor. LL appeared on behalf of NASD's Department of Member Regulation ("Member Regulation").

A. X's Statutorily Disqualifying Event

X is statutorily disqualified because in July 1998, he entered a guilty plea to the felony offense of sexual abuse (third degree). State 1 charged that from May 1996 to August 1997, X had engaged in non-forceable sexual contact with his stepdaughter, who was between the ages of 14 and 15 at the time. He was ordered to complete a sexual offender treatment and substance abuse program, and he was sentenced to serve 10 years in prison (suspended) and a three-year supervised probationary period. X was discharged from probation in July 2001. He also completed sex offender and substance abuse treatment programs; he is not currently involved with any treatment program.

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's stepdaughter also filed a civil action against him, which was settled. X paid a monetary settlement to his stepdaughter; the terms of that settlement are confidential.

B. Background Information

1. X

X was first registered in the securities industry as an investment company/variable contracts representative (Series 6) in January 1983.² He was employed at Firm One from 1982 to 1998 and with Firm One's life insurance entity from January 1982 to May 1997. Both entities terminated his employment in October 1998, after the felony conviction. X then started his own business, X & Associates, where he continues to sell life insurance. X also is a Certified Financial Planner ("CFP"), and he has received his Chartered Financial Consultant ("ChFC") and Chartered Life Underwriters ("CLU") designations since the felony conviction.

In December 1998, State 1 Insurance Division ("the Division") suspended X's insurance producer's license for 30 days because he failed to report to the Division that he had been charged with a felony for sexual abuse. The Division also required X to pay \$2,000 in administrative costs and to serve a three-year probation, with heightened supervision. The Division released X from heightened supervision in 2001. X was also censured by the Board of Professional Review of the Certified Financial Planner Board of Standards, Inc.

In December 2000, the NAC denied a previous MC-400 application by X to be employed by the Sponsoring Firm because: 1) the Firm had proposed off-site supervision; 2) X's felony conviction was recent, and he was still serving probation; and 3) the record showed that X had failed to timely report his felony conviction to State 1 insurance regulators.

2. The Firm

The Sponsoring Firm became an NASD member in 1979. It has 44 branch offices and two offices of supervisory jurisdiction ("OSJs"). The Firm is a full-service brokerage firm and it employs 34 registered principals and 223 registered representatives.

The Firm's last four routine examinations resulted in one letter of Acceptance Waiver and Consent ("AWC") and several Letters of Caution ("LOC's"). The Firm's 1995 routine examination resulted in an AWC for a net capital violation. The Firm and one of its registered persons were censured and fined \$2,500, jointly and severally.

After the 2003 routine examination, NASD issued the Firm an LOC for various violations, including failing to disclose information on research reports, failing to abide by restriction periods for personal trading, inadequate written procedures regarding research reports,

² X requalified as an investment company variable contracts representative in March 2004

inaccurate net capital computations, a continuing education requirement violation, improper TRACE transaction reporting, and recordkeeping violations.

In 2002, following the 2001 routine examination, NASD issued the Firm an LOC for an accounting issue, incorrectly reporting execution times for municipal transactions, a continuing education requirement violation, and inadequate written supervisory procedures regarding continuing education.

After the 1999 routine examination, NASD issued the Firm an LOC for inadequate supervisory procedures regarding variable contracts, failing to timely report two customer complaints, and failing to include all of the required information in written agreements governing networking and brokerage affiliate arrangements.

In 2003, NASD issued the Firm an LOC for failing to submit a hard copy response to NASD's breakpoint survey.

In 1997, NASD conducted an off-cycle municipal examination and issued an LOC to the Firm for failing to transmit transactions to its clearing corporation via a clearing agent, recordkeeping violations, and inadequate written supervisory procedures regarding MSRB rules.

The Firm's next routine examination will be conducted in 2005. The record shows no other disciplinary or regulatory actions against the Firm.

The Firm does not employ any statutorily disqualified individuals and it is not a member of any other self-regulatory organization ("SRO").

C. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes to employ X as an investment company/variable contracts representative, in the capacity of an independent contractor, from the Firm's home office in State 1. The Firm also proposes that the Proposed Supervisor will be X's primary, responsible supervisor. She has been in the securities industry since 1988. She became a general securities representative (Series 7) in February 1992, a general securities principal (Series 24) in November 1993, a financial and operations principal ("FINOP") (Series 27) in October 1985, and a municipal securities principal (Series 53) in February 1996. She has been employed by the Sponsoring Firm since February 1997 and is the Firm's Senior Vice President, Compliance. She has no disciplinary history.

D. Member Regulation's Recommendation

Member Regulation recommends that the Application be approved, subject to the agreed-upon terms and conditions of heightened supervision. Member Regulation notes that the factors cited by the NAC in its December 2000 denial of X's previous application have now been satisfied.

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/variable contracts representative.

In reviewing an application to permit a statutorily disqualified person to become associated with a member firm, NASD has discretion under NASD By-Laws, Art. III, Sec. 3(d) to review:

the relevant facts and circumstances as it, in its discretion, considers necessary to its determination, which, in addition to the background and circumstances giving rise to the failure to qualify or disqualification, may include the proposed or present business of a member and the conditions of association of any current or prospective associated person.

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.

The issues we noted in our December 2000 denial of the Sponsoring Firm's previous application to employ X are not a concern in this Application. First, the Firm has agreed to a plan of on-site supervision for all of X's securities business. He is required to be present in the Firm's home office in State 1, supervised by the Proposed Supervisor, whenever he engages in discussions of securities with his customers. We are persuaded that the Proposed Supervisor, who has been in the financial and securities industry since 1988 without disciplinary history, is a highly qualified supervisor for X, and that she fully appreciates her role as a supervisor for a statutorily disqualified person.

Second, additional time has passed since the July 1998 felony conviction, which permits X to demonstrate that his rehabilitation is ongoing. Further, more than three years have elapsed since our December 2000 denial of the Sponsoring Firm's first application to employ X. X has not been the subject of any securities or life insurance disciplinary proceedings since the Division suspended him in 1998. In addition, he has completed both his court-ordered probation, and the heightened plan of supervision that was ordered by the Division.

Finally, with respect to X's failure to disclose his felony conviction in a timely manner to the Division, the record reflects that in October 2001, the Division sent a letter to NASD that stated: "We represent that our belief is that Mr. X's failure to disclose his offense to the Division, was an unintentional oversight and not a reflection on his ability to be truthful and forthcoming." We also note that X did disclose his felony charge and conviction to NASD in a timely manner.

Accordingly, we find that the Firm and the Proposed Supervisor are capable of supervising a statutorily disqualified individual such as X, and that the following supervisory conditions will provide the enhanced measures necessary to monitor X's activities:

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 must conduct all securities business from the Sponsoring Firm's home office;
3. X will not maintain discretionary accounts;
4. X will not act in a supervisory capacity;
5. The Proposed Supervisor will review daily all of X's business transactions. This review will include all of X's written communications as well as trades entered by X;
6. All new accounts opened by X will require the Proposed Supervisor's approval and the Proposed Supervisor will evidence her approval by initialing the account paperwork;
7. 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 she took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. Documents pertaining to these complaints should be kept segregated for ease of review;
8. 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
9. 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.

We conclude that X's employment in the securities industry will not create an unreasonable risk of harm to the market or investors. NASD certifies that:

1) X meets all applicable requirements for the proposed employment; and 2) X and the Proposed Supervisor have represented that they are not related by blood or marriage.

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Accordingly, in conformity with the provisions of SEC Rule 19h-1, the association of X as an investment company/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