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 a General Securities Representative and General Securities Principal with The Sponsoring Firm	**Redacted Decision** Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 Decision No. SD04001 Dated: 2004

On August 6, 2003, the Sponsoring Firm [1](" the Firm") submitted a Membership Continuance Application ("MC-400" or "the Application") to permit X, a person subject to a statutory disqualification, to associate with the Firm as a general securities representative and general securities principal. In October 2003, a Hearing Panel held hearings on the matter. X appeared and was accompanied by the Sponsoring Firm's chief operating officer and chief compliance officer. PL appeared on behalf of NASD's Department of Member Regulation ("Member Regulation").

A. X's Statutorily Disqualifying Event and Application Process

X is subject to a statutory disqualification, under Section 3(a)(39)(F) of the Securities Exchange Act of 1934 ("Exchange Act") and Article III, Section 4(g) of the NASD By-Laws, as a result of his plea of "no contest" in April 1999, to the felony charge of carrying a concealed weapon on or about his person. The court fined X $2,500. The court did not place him on probation. X paid the $2,500 fine in June 1999. X will remain statutorily disqualified until April 2009.

[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 first became associated with a member firm as a general securities representative in May 1986, and remained with that firm and its successor firm ("Firm 1") until April 2002. X was associated with Firm 1 as a general securities principal from July 1993 through April 2002. In his principal capacity, X's duties included assisting in the management and oversight of the branch office of Firm 1.

As a result of the 1999 disqualifying event, Firm 1 submitted an MC-400 on May 23, 2000, seeking to allow X to remain associated with the firm as a general securities representative and a general securities principal. NASD approved X's association with the sponsoring firm in the capacities requested in an Exchange Act Rule 19h-1 Notice to the Commission in December 2000 (the "December 2000 Notice"). By letter dated January 2001, the Commission's Division of Market Regulation notified NASD that it would not make a negative recommendation to the Commission regarding the application.

In April 2002, X voluntarily terminated his association with Firm 1 to associate with another member firm ("Firm 2"). On May 13, 2002, Firm 2 submitted an MC-400 to permit X to associate with it as a general securities representative. Subsequent to its MC-400 filing, Firm 2 notified Member Regulation in a telephone conversation with Member Regulation staff that, in addition to employing X as a general securities representative, it also intended to employ him as a general securities principal. In September 2002, and January 2003, a Hearing Panel held hearings on the matter. In April 2003, NASD's Office of General Counsel for Regulatory Policy and Oversight received a letter from the member firm requesting that the MC-400 be withdrawn. The request to withdraw was received after NASD's National Adjudicatory Council ("NAC") had considered the Application, but before it issued a decision. The NAC reviewed the withdrawal request and consented to Firm 2's request to withdraw its Application. In May 2003, NASD notified Firm 2 of the NAC's decision.

The Sponsoring Firm then filed its MC-400 on August 6, 2003. The Sponsoring Firm seeks to employ X as a general securities representative and general securities principal.

B. X's Reportable Information

In October 2002, NASD Enforcement staff sent X a Wells letter[2] advising him that it was considering recommending disciplinary action against him based on alleged violations of several NASD Conduct Rules, Section 10(b) of the Exchange Act and SEC Rule 10b-5, as well as a violation of the December 2000 Notice issued pursuant to Exchange Act Rule 19h-1. NASD filed a disciplinary complaint against X in October 2003. The complaint alleges that X: (1)

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[2] A "Wells" letter refers to a letter sent by NASD staff notifying a respondent "that a recommendation of formal disciplinary charges is being considered" and usually provides the respondent with an opportunity to "submit a written statement explaining why such charges should not be brought." NASD Notice to Members 97-55, 1997 NASD LEXIS 77, at *13 (Aug. 1997).

violated the terms of the supervisory conditions in the December 2000 Notice that prohibited him from maintaining discretionary accounts; (2) engaged in unauthorized transactions; (3) recommended unsuitable investments to customers; (4) created and distributed sales literature and a sales letter that violated NASD's advertising rules; and (5) failed to amend his Uniform Application For Securities Industry Registration ("Form U4") to reflect customer complaints.

Three customer complaints were filed against X subsequent to the Commission's January 2001 letter that permitted X to remain associated with Firm 1. Customer CFB filed a complaint with the firm with which X was associated in February 2001, alleging that X churned his account.

Customer SB filed a complaint with NASD in February 2001, alleging that X misinformed her about taxes and fees that she would incur with respect to her IRA rollover account and variable annuity investments. Customer SB filed an arbitration claim seeking damages of $52,000, which was settled by Firm 1 for $35,000. X did not contribute to the settlement.

Joint account holders CB and CB sent a complaint letter to X, dated December 2001, alleging that X had mishandled their account by recommending unsuitable investments and by misrepresenting the investments. Firm 1 settled the complaint for $9,978. X did not contribute to the settlement.

C. The Firm

The Sponsoring Firm has been a member of NASD since March 1991. The Firm has a home office in State 1, and has no Offices of Supervisory Jurisdiction and no branch offices. The Firm employs 10 general securities representatives, two of whom are general securities principals. The Sponsoring Firm is engaged in a general securities business.

In March 1994, NASD issued a letter of caution ("LOC") to the Sponsoring Firm for failing to file timely the Firm's annual audit report, which was filed 18 days late. The Firm responded to the LOC, reporting that it had resolved the deficiency.

D. The Proposed Supervisor and X's Proposed Duties

The Sponsoring Firm proposes to employ X as a general securities representative and a general securities principal at a State 2 office where X currently conducts an investment advisory business. The Sponsoring Firm proposes that the Firm's chief operating officer and chief compliance officer, supervise X from an offsite location. The Proposed Supervisor works at the Firm's home office located in State 1, over 250 miles from X's office in State 2.

The Proposed Supervisor entered the securities business in January 1984 as an investment company products/variable contracts representative. He became a general securities representative in September 1985 and a general securities principal in December 1986. The Proposed Supervisor has been associated with the Sponsoring Firm since May 2003. He has no disciplinary history.

E. Member Regulation's Recommendation

In a letter dated October 2003, Member Regulation recommended that the NAC deny the Sponsoring Firm's Application to employ X, stating that it would not be in the public interest to permit X to associate with the Sponsoring Firm. Member Regulation is concerned about the complaints filed by X's customers after the December 2000 Notice to the Commission that permitted him to remain associated with the firm with which he was associated when he became subject to a statutory disqualification. Member Regulation is also concerned about Enforcement's Wells letter notifying X that it had determined that violations had occurred and that enforcement action was appropriate. Further, Member Regulation questioned the Firm's ability to provide adequate supervision, given that the Firm had only recently been approved to operate a general securities business and, most significantly, that the Proposed Supervisor would be supervising X from the Firm's home office in State 1, a distance of over 250 miles from X's office in State 2.

Member Regulation is also concerned that, contrary to the enhanced supervisory conditions in NASD's Rule 19h-1 Notice, X might have been exercising discretion over certain customer funds.

At the hearing, Member Regulation represented that it did not believe that X could be supervised properly because the complaint that Enforcement filed against X included an allegation regarding X's failure to comply with a heightened supervisory condition from the prior Notice.[3]

F. Discussion

In reviewing this type of application, we have considered whether the particular felony at issue, and other relevant facts and circumstances, create an unreasonable risk of harm to the market or investors.[4] For the reasons set forth below, we conclude that X's participation in the securities industry presents such a risk. We therefore deny the Sponsoring Firm's Application to employ X as a registered representative and a general securities principal.

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[3] Member Regulation did not reference the complaint against X in its October 2003 letter recommending that the Application be denied because the complaint was not filed until October 2003.

[4] 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).

Discretionary trading accounts enable individuals "who lack the time, capacity, or know-how to supervise investment decisions, to delegate authority to a broker who will make decisions in their best interests without prior approval." SEC v. Zandford, 535 U.S. 813, 823, (2002) (emphasis added). A registered representative who is given discretionary authority to buy and sell for the account of his customer "clearly controls" the account. See Peter C. Bucchieri, 52 S.E.C. 800, 805 (1996). Because the degree of control that a registered representative exercises over a discretionary account is at odds with the close supervisory scrutiny that we normally impose on a statutorily disqualified individual, we typically do not allow such individuals to service discretionary accounts. Pursuant to the December 2000 Notice, X is not permitted to handle discretionary accounts.

In considering a statutory disqualification application, we evaluate whether the disqualified individual is likely to abide strictly by the heightened supervisory conditions that we would impose if we approved the Application.[5] Here, we previously approved an application for X to associate with a firm, which prohibited him from servicing discretionary accounts. In considering the current Application, we conclude that X disregarded this condition and operated a discretionary, market-timing program for his customers while associated with a member firm.

At the hearing on the MC-400 that subsequently was withdrawn, X admitted that he and his partner decide when to switch customer funds from one mutual fund to another fund in the same family as part of their "Strategic Journal Transfer" program ("SJT Program"). Indeed, X and his partner manage the SJT Program pursuant to a written "Authorization for Discretionary Accounts" agreement, which enables them to make "switch" decisions without first obtaining the prior approval of SJT Program account-holders.[6]

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[5] Similar to a court's authority to monitor compliance with its previous orders, we have authority to consider whether X disregarded a provision in our December 2000 approval of his firm's statutory disqualification application. Cf. Shillitani v. United States, 384 U.S. 364, 370 (1966) ("There can be no question that courts have inherent power to enforce compliance with their lawful orders through civil contempt."); Hazen v. Reagen, 208 F.3d 697, 699 (8th Cir. 2000) ("Consent decrees . . . are enforceable through the supervising court's exercise of its contempt powers . . . ."); EEOC v. Local 580, International Association of Bridge, Structural & Ornamental Ironworkers, 925 F.2d 588, 593 (2d Cir. 1991) ("[T]hough a court cannot randomly expand or contract the terms agreed upon in a consent decree, judicial discretion in flexing its supervisory and enforcement muscles is broad.").

[6] X submitted a copy of the SJT Program "Authorization for Discretionary Accounts" agreement as an exhibit to the brief that he submitted to the Hearing Panel that considered the MC-400 that was later withdrawn. It provides in relevant part that:

> The client(s) hereby appoint(s) Corporation 1 as the true and lawful attorney-in-fact with respect to the Account(s) listed below to buy, sell, or otherwise exchange the particular mutual funds or variable annuities, all at such time, in such amounts, and at such prices as HPC in its sole discretion

[Footnote continued on next page…]

The plain terms of the Notice prohibited X from maintaining discretionary accounts. At the hearing in the present matter, X stated his view that the Notice did not prohibit him from making market-timing switches. We have determined, however, that market-timing switches are inconsistent with the prohibition in the Notice because X exercises discretion over his customers' accounts.[7] Further, it is impossible for X to satisfy the prohibition because he testified that he is unable to change the servicing of his customers' accounts from a discretionary to a non-discretionary basis.[8]

After careful review of the entire record in this matter, we find that it would not be in the public interest to permit X to become associated with the Sponsoring Firm. We therefore deny the Application.[9]

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

[cont'd]

> may determine. Corporation 1 shall have full authority to communicate such orders directly to the mutual funds or variable annuities managers or companies. The client(s) acknowledge(s) that the mutual funds or variable annuities have no responsibility to review or approve the orders entered by Corporation 1 and hereby agrees to hold them and their employees harmless, with respect to any such responsibility.

(emphasis added.)

[7] X conceded at the hearing in the present matter that his clients have no input on the timing of the market-timing switches or the price at which those transactions are executed.

[8] Unfortunately, X did not address the prohibition on handling discretionary accounts contained in our previous Notice by, for example, seeking relief from it before reinstituting his market-timing program for customers. Such a request to Member Regulation and the NAC would have permitted consideration of the limited nature of the discretionary authority he hoped to exercise.

[9] For purposes of this decision, we have given no weight to the Wells letter, dated October 2002, and the complaint, dated October 2003, that Enforcement filed against X.

LATER CASE HISTORY:

X subsequently appealed this decision to the SEC. The SEC affirmed NASD's decision in this matter.