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 X as a General Securities Representative with The Sponsoring Firm	**Redacted Decision** Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 Decision No. SD04003 Date: 2004

On May 13, 2003, 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 a general securities representative. In July 2003, a subcommittee ("Hearing Panel") of the Statutory Disqualification Committee of NASD held a hearing on the matter. X appeared, accompanied by his proposed supervisor, the Sponsoring Firm's Chief Financial Officer ("CFO"). PL appeared on behalf of NASD's Department of Member Regulation ("Member Regulation").

A. X's Statutorily Disqualifying Event

X is subject to a statutory disqualification because in March 1999, the U.S. District Court for State 1, entered an Order of Permanent Injunction ("Permanent Injunction") against him for making misrepresentations in connection with municipal bond offerings. The court permanently enjoined X from further violating Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b) and 15B(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), Rule 10b-5 promulgated thereunder, and Municipal Securities Rulemaking Board ("MSRB") Rules G-17 and G-19. The court also ordered X to disgorge $600,000 in profits and pay a $40,000 civil penalty.

[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.

The Permanent Injunction was based on a Federal court complaint filed by the SEC, which alleged that: (1) X was the former Chairman of Firm 1; (2) in connection with two "pool" municipal bond offerings, X made material misrepresentations and omissions pertaining to the size of the pools and the intended use of the bond proceeds, and advised the pools to purchase unsuitable securities; (3) in connection with three land development municipal bond offerings, X made material misrepresentations and omissions pertaining to the value of the land, the developer, and the capitalization of the project; and (4) X sold securities in contravention of MSRB Rules G-17 and G-19.

The court ordered X and Firm 1 to disgorge $600,000, which represented the profits they made from their purchases and sales of the municipal bonds at issue. The disgorged funds were disbursed to the municipal bond trustees to be placed into redemption accounts to be used to repurchase, redeem, or pay principal or interest on bonds.

The SEC also brought an administrative proceeding based on this misconduct. In May 1999, X consented to, and the SEC entered, an Order Instituting Public Administrative Proceedings, Making Findings and Imposing Remedial Sanctions ("SEC Bar Order"). The SEC Bar Order barred X from association with any broker-dealer, municipal securities dealer, investment adviser or investment company, but provided that he could reapply for association with the appropriate self-regulatory organization after three years. The administrative proceeding was based on the entry of the order of Permanent Injunction described above.

B. Background Information

1. X

X was employed in the securities industry from 1967 to 1999. He passed the Series 1 (investment company products/variable contracts representative, general securities representative qualification examination) in August 1967;[2] the Series 000 (NYSE representative qualification examination) in November 1973; the Series 40 (registered principal qualification examination) in October 1975; the Series 5 (interest rate options qualification examination) in October 1981; and the Series 41 (NYSE allied member qualification examination) in June 1983. In addition, X became registered as a Series 53 (municipal securities principal) in January 1981; and a Series 24 (general securities principal) in April 1985.[3]

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[2] The Series 1 examination was replaced by both the Series 6 (investment company products/variable contracts representative examination) and the Series 7 (general securities representative examination) in the early 1970's.

[3] The Series 40 qualification examination was revised in 1979 into the Series 24 qualification examination. As a result of X's qualification as a Series 40, he was given a waiver in April 1985 for the Series 24 qualification examination.

Due to X's absence from the securities business for more than two years, all of the above-mentioned registrations have expired. X retook and passed the Series 7 (general securities representative qualification examination) in October 2002.

(a) Regulatory History

NASD's Central Registration Depository ("CRD®") record shows that X has not been the subject of any additional regulatory action since the imposition of the SEC Bar Order in May 1999.

X's CRD® record includes two disciplinary matters prior to the 1999 SEC Bar Order. In 1994, NASD accepted a Letter of Acceptance, Waiver and Consent ("AWC") from Firm 1 and X for violating the NASD Board of Governors' Interpretation on Free-Riding and Withholding. X was censured and fined $2,500.

In March 1998, NASD accepted an Offer of Settlement from Firm 1 and X for failing to complete a training needs analysis, and failing to establish and maintain written supervisory procedures regarding continuing education requirements and the review of political contributions. X was censured, fined $5,000 (jointly and severally with Firm 1), and ordered to requalify in any principal capacity in which he sought to be registered with NASD.

2. The Firm

The Sponsoring Firm became a member of NASD in May 1967 and the State 2 Stock Exchange in August 1997.[4] The Firm has 133 offices of supervisory jurisdiction ("OSJs") and 46 branch offices. In addition, the Firm employs 59 registered principals and 135 registered representatives. The Sponsoring Firm is engaged in a general securities business.

The Firm does not employ any statutorily disqualified individuals.

(a) Regulatory History

The Sponsoring Firm has been the subject of the following formal and informal disciplinary actions. In 2002, NASD issued the Sponsoring Firm a Letter of Caution ("LOC") for failing to have adequate written supervisory procedures to address the review of discretionary accounts and uncovered short option contracts. The Firm responded to the LOC in writing in January 2003, with a description of the steps it has taken to ensure future compliance with NASD's rules.

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[4] In a letter dated September 2003, the State 2 Stock Exchange informed Member Regulation that it concurs with Member Regulation's recommendation to approve the Application to permit X to be a general securities representative with the Sponsoring Firm.

In May 2002, NASD informed the Sponsoring Firm that it was required to take part in a Compliance Conference with members of NASD's examination staff. The Compliance Conference was held, and the Firm subsequently submitted a letter to NASD that described how it would implement changes to ensure that the matters raised were properly addressed.

In 2001, NASD accepted an AWC from the Sponsoring Firm and fined the Firm $7,500 for violations of the OATS rules.

In 2000, NASD issued the Firm an LOC for failing to have adequate written supervisory procedures in several areas, including distribution of options education material and options disclosure documents, and opening new accounts. NASD also noted several trade reporting and recordkeeping violations. The Firm responded to the LOC in writing in December 2000, with a description of the steps it has taken to ensure future compliance with the rules.

In 2000, NASD accepted an AWC from the Sponsoring Firm for 19 failures to report corporate debt securities transactions. The Firm also failed to register as a Fixed Income Pricing System ("FIPS") participant. NASD fined the Firm $6,000.

In 1999, NASD accepted an AWC from the Sponsoring Firm for failing to designate late ACT transactions and failing to establish, maintain and enforce written supervisory procedures designed to achieve compliance with the applicable rules relating to trade reporting. NASD censured the Firm and fined it $7,500.

In 1998, NASD accepted an AWC for the Sponsoring Firm's failure to file option position reports and failure to establish, maintain, and enforce adequate written supervisory procedures regarding reporting option positions. NASD censured the Firm and fined it $15,000.

C. X's Proposed Business Activities And Supervision

The Sponsoring Firm proposes to employ X as a general securities representative in the Firm's home office in State 1. X will work to develop a new business plan and explore new business ventures for the Firm by finding new business opportunities that he will propose to the Firm. According to the Firm's Application, these new business ventures may include strategic alliances and joint ventures with trading partners. X will conduct meetings with business prospects outside the office.

X will propose these new ventures to his proposed supervisor, who may present them to the executive management of the Firm for consideration. The executive management of the Firm will have the discretion as to whether these proposed ventures will be pursued. If the Firm's management chooses to move forward with any proposal, they will submit it to the Sponsoring Firm's Board of Directors for a vote.

The Sponsoring Firm proposes that the Proposed Supervisor serve as X's responsible supervisor. The Proposed Supervisor, who is the CFO and an Executive Vice President of the Firm, has been in the securities industry since 1970. He became registered with the Sponsoring

Firm in January 1990. He passed the Series 40 (registered principal qualification examination) in May 1970; the Series 4 (registered options principal qualification examination) in February 1979; the Series 14 (NYSE compliance principal qualification examination) in October 1989; the Series 63 (uniform securities agent state law qualification examination) in March 1997; and the Series 55 (limited representative – equity trader) in March 2000. In addition, the Proposed Supervisor was registered as a Series 27 (financial and operations principal) in January 1978.

The Proposed Supervisor has no informal or formal disciplinary or regulatory history.

D. Member Regulation Recommendation

Member Regulation recommends that the Application be approved, subject to agreed-upon terms and conditions of heightened supervision. Member Regulation's recommendation, however, was based on the presumption that the Commission's decision in Paul Edward Van Dusen, 47 S.E.C. 668 (1981), precluded NASD from denying the Application based upon the nature of the underlying misconduct that resulted in the Permanent Injunction. To the degree that the Van Dusen decision stands for that proposition, however, we believe that the Commission has failed to give proper consideration and weight to the separate regulatory function in which NASD must engage when considering the readmission of an applicant. We therefore have decided to exercise that independent judgment and, under the facts and circumstances of this matter, we believe that the Application should be denied, for the reasons stated below.

E. Discussion

After carefully reviewing the entire record in this matter, we deny the Sponsoring Firm's Application to employ X as a general securities representative. We base our denial primarily on the conclusion that, in light of the serious and recent nature of X's securities fraud, X has not demonstrated that his association with an NASD firm would serve the public interest.

X is the subject of two statutorily disqualifying events: the March 1999 Permanent Injunction and the 1999 SEC Bar Order. We are primarily concerned here with the circumstances surrounding the entry of the Permanent Injunction. The misconduct underlying the entry of the Permanent Injunction was substantial and egregious securities fraud, which requires scienter, "a mental state embracing intent to deceive, manipulate, or defraud." Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976). X's fraud included making material misrepresentations and omissions regarding the size of pools and the intended use of bond proceeds in connection with two pool municipal bond offerings, and making material misrepresentations and omissions pertaining to the value of the land, the developer, and the capitalization of the project in connection with three land development municipal bond offerings. His conduct also involved other serious violations of law, namely advising the pools to purchase unsuitable securities. X profited substantially from his misconduct, as reflected in the order to disgorge $600,000 in profits. The conduct in question, moreover, having occurred in the early 1990's, is not so ancient that we think the mere passage of time provides sufficient basis to permit the applicant to return to the industry.

In its role as a regulator of the securities industry, NASD has a responsibility to evaluate applications to act in registered capacities by scrutinizing all of the facts and circumstances surrounding an applicant who comes before it seeking readmission. That responsibility is separate and independent of the authority being exercised by the SEC when it determines to bar a person from the securities industry with a right to seek readmission after a period of time. Even though the SEC has granted the person the right to seek readmission, it remains NASD's responsibility to evaluate whether the readmission of the applicant will be in the public interest and will be consistent with the protection of investors. We believe that, in order to discharge that responsibility, NASD must by necessity consider all relevant past conduct, as well as the proposed plans for supervising the applicant. That consideration most particularly must include activities that underlie an extant permanent injunction prohibiting future violations of the securities laws, which may have also led those persons to be barred from the industry.

In this instance, X was found to have engaged in extremely serious securities fraud, involving repeated misrepresentations in multiple offerings, resulting in substantial profits. That fraud occurred while he was serving in a senior management position in his company. Under those circumstances, we believe that it is not in the public interest nor consistent with the protection of investors to permit X to be readmitted at this time.

Our denial of X's Application is consistent with our position in other statutory disqualification matters and disciplinary cases involving findings of securities fraud. See Morton Kantrowitz, 52 S.E.C. 721, 724 (1996) (Commission upheld NASD's denial of Kantrowitz' application to re-enter the securities business, stating that he "lack[ed] the integrity demanded of those working in the securities industry."); Department of Market Regulation v. Fiero, 2002 NASD Discip. LEXIS 16 (NAC, Oct. 28, 2002) (Firm's president barred and firm expelled when president knew of the manipulation or the market manipulation was so obvious that he must have been aware of it). It is also consistent with the purposes of the Exchange Act. See Section 15A of the Exchange Act (requiring the Commission to determine that an SRO's rules were "designed to prevent fraudulent and manipulative acts and practices"); see also U.S. v. O'Hagan, 521 U.S. 642, 658 (1997) (stating that an "animating purpose" of the Exchange Act was to "insure honest securities markets and thereby promote investor confidence.")

Van Dusen states that, in cases in which the Commission has settled an administrative proceeding involving the same misconduct that underlies a permanent injunction and has imposed a bar with the right to reapply after a specified time, NASD may not consider the underlying misconduct in a subsequent application by the barred person to re-enter the securities industry at the expiration of the limited bar. Rather, the Commission suggested that NASD's consideration of such an individual's application should be limited to: (1) any intervening misconduct in which the individual has engaged; (2) the nature and disciplinary history of the prospective employer; and (3) the supervision to be accorded the applicant. Id.

With all due respect to the Commission's 1981 decision, we strongly believe that this guidance in Van Dusen fails to take into account properly the separate analysis in which NASD is charged with engaging when an applicant seeks readmission. It conflates two separate

processes – the one in which someone is barred from the industry and given the ability after a period of time to reapply, and the separate process by which NASD is charged with the duty to evaluate whether an applicant can be permitted to function in a particular registered capacity consistent with the public interest and investor protection. NASD should not be restricted in its ability to discharge that obligation by considering the totality of circumstances presented by an application.[5]

We also believe that Van Dusen appears to be premised on the assumption that perpetrators of serious and repeated securities fraud, such as X, can be successfully employed by a broker-dealer after a few years as long as a firm establishes heightened supervision. All forms of supervision can be frustrated if the subject of the supervision is sufficiently committed to evading detection. In this case, where the fraud was recent, repeated, serious, and involved a member of senior management, we believe that the goal of investor protection requires a decision that avoids creating a risk of a recurrence of securities fraud.

We do not believe that our consideration of the circumstances resulting in the earlier sanctions, particularly the imposition of a Permanent Injunction, either punishes X twice for the same offense or reflects a reconsideration of or challenge to the Commission's decisions or agreements in the earlier proceedings. It is simply a recognition of the relevance of the original conduct to the prudential judgment the NASD is charged with making about the wisdom and propriety of readmitting the applicant to the securities industry. It certainly does not preclude this applicant, or any applicant, from reapplying in the future.

Accordingly, we conclude that permitting X to re-enter the securities industry at this time would present an unreasonable risk of harm to the market or investors and would be contrary to the public interest. We therefore deny the Sponsoring Firm's Application to employ X as a general securities representative.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary

[5] NASD, of course, was not a party to the negotiations that led the Commission to settle its administrative proceeding against X.

LATER CASE HISTORY:

X requested a review by the SEC of the NAC's decision. In 2005, the SEC remanded the NAC's denial. In 2006, the NAC issued a decision approving X's association with the Sponsoring Firm. (See SD Decision No. 06004.)