BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X as a General Securities Representative with The Sponsoring Firm	Redacted Decision Notice Pursuant to Rule 19h-1 Securities Exchange Act of 1934 Decision No. SD07002 Date: 2007

I. Procedural Background

In May 2006, the Securities and Exchange Commission remanded a September 29, 2005 National Adjudicatory Council ("NAC") decision denying a statutory disqualification application ("MC-400" or "the Application") that sought to permit X to associate as an investment company products/variable contracts representative with the Sponsoring Firm ("the Firm"). The Commission rejected the NAC's conclusion not to follow the Commission's previous decisions in *Paul Edward Van Dusen*, 47 S.E.C. 668 (1981) and *Arthur H. Ross*, 50 S.E.C. 1082 (1992). *[CASE REDACTED]*. In November 2006, the Commission denied the Financial Industry Regulatory Authority's[1] motion for reconsideration of the Commission's May 2006 remand and instructed the NAC to employ the analysis set forth in *Van Dusen* and *Ross* to X's[2] application on remand. *[CASE REDACTED]*.

In light of the Commission's instructions, a remand subcommittee ("Remand Hearing Panel") of FINRA's Statutory Disqualification Committee requested that the parties submit further documentation in support of, or against, the Application for X to re-enter the securities industry. In January 2007, the Firm submitted a letter stating that it continues to support X's association and proposing newly drafted heightened supervisory procedures. Member

[1] As of July 30, 2007, NASD consolidated with the member firm regulation functions of NYSE and began operating under a new corporate name, the Financial Industry Regulatory Authority ("FINRA"). References in this decision to FINRA shall include, by reference and where appropriate, references to NASD.

[2] 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.

Regulation's first submission on remand, dated February 2007, continued to recommend a denial of the Application. In response to an April 2007 request from the Remand Hearing Panel, however, Member Regulation reevaluated the Application in accordance with the Commission's instructions regarding *Van Dusen* and submitted a letter dated April 2007, recommending approval of the Application.

In April 2007, the Remand Hearing Panel held a hearing on the matter.[3] X appeared at the hearing, accompanied by his counsel and by his proposed supervisor. LL and JBK appeared on behalf of FINRA's Department of Member Regulation ("Member Regulation"). The Remand Hearing Panel requested that the parties submit a joint post-hearing letter addressing questions regarding appropriate registrations for X and the Proposed Supervisor and outlining an agreed-upon plan of heightened supervision. In May 2007, the parties submitted the requested letter, stating that X must be registered as a general securities representative (Series 7) to be involved in sales of direct participation programs, and that the Proposed Supervisor is qualified to supervise X in that capacity because the Proposed Supervisor is registered as both an investment company products/variable contracts limited principal (Series 26) and a direct participation programs limited principal (Series 39).[4] The parties also jointly submitted a newly proposed plan of heightened supervision.

For the reasons explained below, we have considered the Firm's renewed Application, and we approve its request for X to return to the securities industry as a general securities representative.

II. The Statutorily Disqualifying Event

X is statutorily disqualified pursuant to Art. III, Sec. 4 of FINRA's By-Laws[5] because, in 2003, FINRA's Department of Enforcement ("Enforcement") accepted his submission of a Letter of Acceptance, Waiver and Consent ("AWC") for willfully failing to disclose material information on a Uniform Application for Securities Industry Registration or Transfer ("Form U4"). FINRA suspended X for six months in any capacity and imposed a $7,500 fine. The AWC also specifically provided that:

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[3] Pursuant to NASD Rule 9524(a)(10), the Remand Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. In turn, the Statutory Disqualification Committee considered the Remand Hearing Panel's recommendation and presented a written recommendation to the NAC, in accordance with NASD Rule 9524(b)(1).

[4] Accordingly, the Firm revised its Application to request that X be permitted to associate in such capacity.

[5] Art. III, Section 4 of FINRA's By-Laws refers to Section 3(a)(39) of the Securities Exchange Act of 1934 ("the Exchange Act"), which provides that it is a statutorily disqualifying event to willfully provide false or misleading statements of material fact in a membership application to a self-regulatory organization.

> X understands that this settlement includes a finding that . . .
> he willfully failed to disclose a material fact on a Form U-4, and . . .
> he willfully misrepresented a material fact on a Form U-4 amendment,
> and that . . . he is therefore subject to a statutory disqualification
> with respect to association with a member.

In the AWC, X consented to FINRA's finding that, in October 1999, he willfully failed to disclose material facts on a Form U4 filed on his behalf by his former securities industry employer, Firm 1. The material facts at issue were that: 1) in September 1987, the United States Attorney's Office for State 1 charged X with two felony counts of filing false federal income tax returns; and 2) in September 1987, X pled guilty to one felony count of filing a false federal income tax return.[6] X also consented in the AWC to FINRA's finding that in April 2000, he misrepresented on an amended Form U4 that he submitted to Firm 1 that these criminal charges and his guilty plea involved a misdemeanor, when he knew, or should have known, that they involved a felony.

III. Background Information

A. X

X first registered in the securities industry with Firm 1 as an investment company products/variable contracts representative in March 2000. He also passed qualifying examinations for uniform securities agent state law (Series 63) in March 2000, general securities representative (Series 7) in September 2001, and uniform investment advisor (Series 65) in November 2001. Firm 1 employed X from January 2000 until January 2003, when it discharged him for violating company policies relating to correspondence and seminar review.[7] X has not been employed in the securities industry since that time. He has been selling life and casualty insurance through companies located in State 1 and State 2. He has also been receiving fees from a registered investment advisory firm for managed accounts that he transferred from Firm 1.

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[6] On his 1981 federal income tax return, X reported taxable personal income of $15,061, instead of the true amount, which was $48,879. This misconduct ceased to be a statutorily disqualifying offense in September 1997, which was 10 years after the date that X pled guilty and was convicted of the felony. *See* Art. III, Sec. 4 of FINRA's By-Laws (referring to Section 3(a)(39) of the Exchange Act, which provides that any felony conviction within 10 years of the filing of an application for membership is a statutorily disqualifying event).

[7] According to the Uniform Termination Notice for Securities Industry Registration ("Form U5") and X's testimony at the initial hearing held in 2005, Firm 1 placed X under heightened supervisory conditions in December 2001, after it became aware of FINRA's investigation into the circumstances underlying the AWC. X violated certain of those conditions when he failed to submit written materials to Firm 1 prior to conducting seminars, and therefore Firm 1 terminated him.

In February 2002, the Treasurer of the State Department of State 3 found that X made a material misstatement on an application for an insurance license by failing to disclose his November 1987 income tax fraud conviction. X consented to an administrative order imposing a $1,500 fine and a one-year probation.

In July 2002, the State 2 Department of Insurance found that X had failed to disclose his November 1987 income tax fraud conviction on an application for an insurance license. State 2 fined X $500.

Prior to his entry into the securities industry in 2000, X had been employed in the aerospace defense industry. In 1978, he founded a company named Firm 2 that acted as an engineering specialist and a manufacturer's representative and distributor specializing in process control and factory automation equipment. X sold certain of his Firm 2 interests in 1998 and began working in the insurance industry.

The record shows no customer complaints or other disciplinary or regulatory actions against X.

B. The Firm

The Sponsoring Firm became a FINRA member in 1994. The Firm has only one office—its home office in City 1. It employs one registered principal, the Proposed Supervisor, and two non-registered employees. It is engaged as an introducing broker-dealer selling mutual funds, variable life insurance, annuities, and direct participation programs.

FINRA's last two routine examinations of the Firm resulted in a finding of Filed Without Action in 1999 and a Letter of Caution ("LOC") in 2003. FINRA issued the 2003 LOC to the Firm for failing to have written supervisory procedures addressing continuing education; allowing an individual to become inactive due to failure to comply with continuing education requirements; and failing to file a Form U5 within 30 days of an individual's termination.

FINRA has begun, but not yet completed, its 2007 routine examination of the Sponsoring Firm.

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

IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes to employ X as a general securities representative in its home office in City 1. The Firm will compensate him solely through commissions.

The Firm also proposes that the Proposed Supervisor will be X's primary supervisor. The Proposed Supervisor is the President of the Sponsoring Firm, and he has been with the Firm since its inception in August 1994. The Proposed Supervisor has been employed in the securities industry since 1973, having qualified as a general securities representative in October 1973, an investment company products/variable contracts limited principal (Series 26) in May 1987 and October 1994, and a direct participation programs limited principal (Series 39) in February 1985.

The record shows no disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be approved.

VI. Discussion

We have carefully considered the entire record in this matter, including the post-hearing submissions from the parties. Based on this record, and pursuant to the Commission's controlling decisions in this area, we approve the Firm's Application to employ X as a general securities representative, subject to the supervisory terms and conditions set forth below.

A. The Legal Standards

The legal framework that governs our review is set forth in *Van Dusen*, which provides that in situations where the Commission has already addressed an individual's misconduct through its administrative process and has chosen to impose certain sanctions for that misconduct, FINRA generally should not evaluate a statutory disqualification application based on the individual's underlying misconduct. The Commission stated that when the period of time specified in its order has passed, in the absence of "new information reflecting adversely on [the applicant's] ability to function in his proposed employment in a manner consonant with the public interest," it is inconsistent with the remedial purposes of the Exchange Act and unfair to deny an application for re-entry. 47 S.E.C. at 671.

The Commission's *X* decision extended the reach of the *Van Dusen* framework by stating that FINRA must apply the principles articulated in *Van Dusen* to situations where FINRA itself has imposed a suspension or a bar with the right to reapply for the misconduct underlying a statutory disqualification, and the statutorily disqualified individual subsequently applies to re-enter the industry. *[CASE REDACTED]*.

We note, however, that the Commission also stated in *Van Dusen* that an applicant's re-entry is not "automatic" after the expiration of a given time period. Instead, the Commission instructed FINRA to consider other factors, such as: 1) intervening misconduct in which the applicant may have engaged; 2) the nature and disciplinary history of the prospective employer; and 3) the supervision to be accorded the applicant. 47 S.E.C. at 671.

After applying the *Van Dusen* framework to this matter, we approve the Application.

1) No Intervening Misconduct

At the remand hearing, Member Regulation stated that it had reviewed the documents that were in Enforcement's files prior to its issuing the 2003 AWC, which contained copies of X's prior applications for insurance registrations with State 1, State 2, State 3, and State 4.[8] With the exception of the State 1 application, X made misrepresentations on the applications for the other states, and CRD shows that two of those states—State 2 and State 3—sanctioned him in 2002 for those misrepresentations. Moreover, the 2003 AWC itself specifically referred to Firm 1's discharge of X in February 2003. Accordingly, we have considered that, prior to issuing the November 2003 AWC, Enforcement evaluated all of the circumstances regarding X's failure to disclose on his Forms U4, along with his other disciplinary history, and determined to impose a six-month suspension in all capacities and a $7,500 fine.

We further note that there is no indication in the record that X has engaged in any intervening misconduct since Enforcement's November 2003 AWC.

Accordingly, pursuant to *Van Dusen* and its progeny, here we do not look to X's disciplinary history or the underlying misconduct that led to his statutory disqualification in evaluating the Application. We thus find that the Application meets the first prong of the *Van Dusen* framework because we are not aware that X has engaged in any intervening misconduct.

2) The Nature and Disciplinary History of the Sponsoring Firm

Next, we consider the nature and disciplinary history of the Sponsoring Firm and whether it will affect the Firm's ability to supervise X.

The record shows that the Sponsoring Firm has no formal disciplinary history since its inception in 1994. The 2003 LOC issued by FINRA is the only informal action on the Firm's disciplinary record.

We therefore conclude that the Firm's past disciplinary history will not affect its ability to effectively supervise X in his proposed responsibilities as a general securities representative, working from the Sponsoring Firm's home office.

3) The Firm's Proposed Supervisory Structure for X

Finally, we consider the Firm's proposed supervisory structure for X.

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[8] In a letter dated April 2007, the Remand Hearing Panel requested that Member Regulation address this issue, as the Commission's *X* decision had questioned exactly what information was before, and considered by, Enforcement prior to its November 2003 acceptance of the AWC. *[CASE REDACTED]*.

The Firm has designed a comprehensive structure for X's return to the securities industry. In addition to other heightened supervisory conditions, X is prohibited from having discretionary accounts or acting in a supervisory capacity. Moreover, X's investment activities will be limited to marketing products that the Sponsoring Firm is permitted to sell through its membership agreement—mutual funds, variable annuities, variable life products, and direct participation programs.

The proposed supervisor has worked in the securities industry since 1973 with no disciplinary history. The Proposed Supervisor is qualified to supervise X in his proposed duties because the Proposed Supervisor has been a direct participation programs limited principal since 1985 and an investment company products/variable contracts limited principal since May 1987. Because the Proposed Supervisor is the Firm's only principal, he will be required, even if he is on vacation or out of the office, to continue to review all of X's correspondence and e-mails. The Proposed Supervisor testified at the remand hearing that when he is absent from the office, he nonetheless maintains constant electronic communication via computer or wireless e-mail device.

In sum, given the Commission's precedent in *Van Dusen* and its ruling in *X*, we conclude that the following supervisory conditions proposed by the Sponsoring Firm will provide the enhanced compliance measures necessary to monitor X's activities:[9]

1. The 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 supervise X on-site, in the Firm's home office in City 1, State 1;

3. X will not handle discretionary accounts;

4. X will not act in a supervisory capacity;

5. Because the Sponsoring Firm is an introducing broker-dealer, X's investment activities will be limited to the products that the Sponsoring Firm is permitted to sell. As a general securities representative, X will only be allowed to market products such as direct participation programs, mutual funds, variable annuities, and variable life products. The Proposed Supervisor must pre-approve all transactions and document his approval by dating and signing the paperwork and maintaining it at the Firm's home office;

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[9] All of the terms and conditions of the plan of heightened supervision are special requirements for X and are not standard operating procedures of the Firm.

6. The Proposed Supervisor will review all of X's incoming correspondence upon its arrival and all of X's outgoing correspondence before it is sent (correspondence includes letters and e-mail messages);

7. X must disclose to the Proposed Supervisor all customer meetings at the time they are scheduled or, in the case of unscheduled meetings, as soon as practicable after they occur;

8. Based on X's monthly transaction activities, the Proposed Supervisor will randomly contact at least 10% of X's customers, on a monthly basis, to ensure that X has conducted himself in an appropriate manner and has complied with the Firm's written supervisory procedures. The Proposed Supervisor will memorialize his findings in writing and keep them segregated for ease of review during any statutory disqualification examination;

9. The Proposed Supervisor will review and pre-approve each account prior to the opening of the account by X. The Proposed Supervisor will document his approval by dating and signing the account paperwork and maintaining it at the Firm's home office;

10. The Proposed Supervisor will meet with X, on a quarterly basis, to review his transactions with clients and will keep a log of these meetings;

11. For the purposes of client communication, X will use only the Firm's e-mail account, with all e-mails being filtered through the Firm's e-mail system. The Sponsoring Firm is required to equip its e-mail system with a filtering system that will block any e-mails that are either sent to or received from X's personal e-mail account. X will inform the Firm of all outside e-mail accounts that he maintains. The Proposed Supervisor will preserve and keep X's e-mail messages for ease of review during any statutory disqualification examination;

12. All customer complaints pertaining to X, whether oral or written, will be immediately referred to the Proposed Supervisor for review. The Proposed Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint and the resolution of the matter. The Proposed Supervisor will keep all documents pertaining to these complaints segregated for ease of review during any statutory disqualification examination;

13. When the Proposed Supervisor is on vacation or out of the office, he will continue to be required to review all correspondence, including e-mails and letters, received or sent by X. X's incoming and outgoing mail will be scanned by a member of the Proposed Supervisor's staff via PDF or facsimile, thereby enabling the Proposed Supervisor to review all of X's correspondence. In the Proposed Supervisor's absence, X will not conduct customer transactions without the Proposed Supervisor's review and approval. The Proposed Supervisor will again

review and initial all of X's customer transactions upon the Proposed Supervisor's return to the office;

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

15. The Proposed Supervisor must certify quarterly (March 31, June 30, September 30, and December 31) to the Firm's compliance department that he and X are in compliance with all of the above conditions of X's heightened supervision plan.

FINRA 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 employ any other statutorily disqualified individuals.

VII. Conclusion

Accordingly, we approve the Sponsoring Firm's Application to employ X as a general securities representative. In conformity with the provisions of Exchange Act Rule 19h-1, the association of X as a general securities representative with the Firm 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,

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Barbara Z. Sweeney, Senior Vice President and Corporate Secretary