BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

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| In the Matter of the Association of<br><br>X<br><br>as a<br><br>General Securities Representative<br><br>with<br><br>The Sponsoring Firm | Redacted Decision<br><br>Notice Pursuant to Section 19(d) Securities Exchange Act of 1934<br><br>SD08003<br><br>Date: 2008 |

## I. Introduction

On September 12, 2007, the Sponsoring Firm[1] submitted a Membership Continuance Application ("MC-400" or "the Application") with the Financial Industry Regulatory Authority's[2] Department of Registration and Disclosure, seeking to permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as a general securities representative. In March 2008, a subcommittee ("Hearing Panel") of FINRA's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, accompanied by his counsel, his proposed primary supervisor ("the Proposed Supervisor"), and the Firm's chief compliance officer ("Employee 1"). FINRA Employee 1 and FINRA Attorney 1, appeared on behalf of FINRA's Department of Member Regulation ("Member Regulation").

[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.

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

For the reasons explained below, we deny the Sponsoring Firm's Application.[3]

## II. The Statutorily Disqualifying Event

X is statutorily disqualified because in 2006, the NAC issued a decision imposing a bar in all capacities on X for his failure to respond to FINRA's repeated requests for information in an ongoing investigation regarding the adequacy of research reports. [Case Redacted]. The NAC decision also found that X and his previous firm,[4] Firm 1, negligently issued research reports that failed to include required disclosures and contained misleading information. [Case Redacted]. The NAC stated that it would have imposed a 60-day suspension and a $20,000 fine for the inadequate research reports, but did not do so because of the bar for X's failure to respond. [Case Redacted].

## III. Background Information

### A. X

#### 1. *Employment History*

X first registered in the securities industry as a financial and operations principal (Series 27) in 1983. He qualified as a general securities representative (Series 7) in 1983 and as a general securities principal (Series 24) in 2001. He was previously associated with 14 firms between June 1982 and February 1993, when he formed Firm 1.

X currently serves as president of Firm 2, an investment services company that he incorporated in State 1 in June 2007. X owns 100 percent of Firm 2, which provides all investment related services to Firm 3, a State 1 limited liability company of which X is the sole member and shareholder. Firm 3 is the investment management company for Firm 4, a mutual fund company operating out of the Cayman Islands. X represented at the hearing that, if FINRA permits, he proposes to continue his work with Firm 2 if he re-enters the securities industry.

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

[4] X's previous firm was known by three different names over its existence: Firm 1A, Firm 1B, and Firm 1C). For the purposes of this decision, we shall refer to the firm as "Firm 1."

2. *Prior Disciplinary History*

In addition to the recent unqualified bar that brings X before us as a statutorily disqualified individual, his disciplinary record includes three prior FINRA formal actions.

In 1994, FINRA accepted a Letter of Acceptance, Waiver and Consent ("AWC") submitted by X and Firm 1. The AWC censured and fined the respondents $7,500, jointly and severally, for failing to obtain an amendment to the firm's restriction agreement with FINRA.

In 1998, FINRA accepted an AWC from X and Firm 1 for failing to develop a written training plan, and failing to develop and maintain a continuing and current education program for registered representatives in 1996 and 1997. FINRA censured the respondents and imposed a $2,500 fine, jointly and severally.

In 2000, FINRA accepted an AWC submitted by X and Firm 1 for numerous violations, including: 1) failing to keep written records of affirmative determinations in short sale transactions that the firm effected for its own account or the accounts of its customers; 2) failing to report sales transactions as short sales to Nasdaq's Automated Confirmation Transaction Service; 3) failing to file advertisements with FINRA's Advertising Department; 4) failing to maintain advertisement files; 5) failing to disclose the firm's name on Bulletin Board advertisements posted by associates of the firm; 6) failing to provide the price of securities in research reports; 7) failing to disclose risks of short selling in research reports that recommended short sales; 8) issuing research reports that failed to provide a sound basis for evaluation, omitted material facts or made misleading statements or claims; and 9) failing to establish, maintain and enforce procedures reasonably designed to achieve compliance with advertising rules, short selling rules, and trade reporting rules. FINRA ordered the respondents to retain an independent consultant to review and make recommendations concerning the adequacy of the firm's policies and procedures, to remove all advertisements on Firm 1's website and refile them with FINRA's Advertising Department, and to pre-file any future advertisement with FINRA's Advertising Department 15 days prior to use. FINRA also censured and fined the respondents $75,000, jointly and severally, and ordered X to requalify as a general securities principal within 60 days. X requalified as a general securities principal in 2001.

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

B. <u>The Firm</u>

The Sponsoring Firm is based in City 1 State 2 and it has been a FINRA member since 1999. The Firm has one office of supervisory jurisdiction ("OSJ"), no

branch offices, and it employs three registered principals and five registered representatives. The Firm's MC-400 represents that it "specializes in illiquid high yield, distressed and emerging market situations, particularly those that are 'under-followed.'" FINRA has approved Sponsoring Firm to engage in a general securities business, and Proposed Supervisor represented that Sponsoring Firm deals only with institutional customers.

FINRA has begun, but not yet completed, its 2008 routine examination of the Firm.

After its 2006 routine examination, FINRA issued Sponsoring Firm a Letter of Caution ("LOC") for late transaction reporting. Sponsoring Firm responded in a 2006 letter stating that it had addressed the deficiencies noted.

FINRA's 2004 routine examination was filed with a finding of no deficiencies.

FINRA issued the Firm an LOC after the 2002 routine examination for late amendments to its Form BD, FOCUS filing deficiencies, and improper records on order tickets and confirmations. FINRA did not ask Sponsoring Firm to respond to this LOC.

The record shows no other disciplinary history, complaints, or arbitrations against the Firm.

## IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes to employ X as a general securities representative in its only location, the OSJ in City 1, State 2. The Sponsoring Firm describes X's proposed duties as "Internal Research and Sales," stating that he will limit his analysis of companies to the Firm's internal use, will discuss only companies that the Firm has previously approved for him as indicated in the proposed heightened supervisory procedures, and will be restricted from writing and distributing research for public consumption. The Sponsoring Firm also states that X will "have contact with our institutional client base and discuss potential sales transactions of those companies regarding which he is approved to correspond." The Firm proposes to compensate X on a commission-only basis.

The Firm proposes that Proposed Supervisor will be X's primary supervisor, with assistance from several "back-up" supervisors, and they will work in close proximity in the same office. Proposed Supervisor qualified as a general securities representative in September 1987 and as a general securities principal in September 1998. He is a managing member of the Firm and serves as its chief compliance officer and president. He is also a direct owner of Sponsoring Firm, owning 53.5 percent of the Sponsoring Firm's limited liability company's membership interest. Proposed

Supervisor currently directly supervises four other individuals at Sponsoring Firm, none of whom is subject to heightened supervisory procedures. Proposed Supervisor previously was associated with seven different brokerage firms between July 1989 and January 1999, when he formed Sponsoring Firm. The record shows no disciplinary history for Proposed Supervisor.

The Sponsoring Firm has proposed heightened supervisory procedures to govern X's activities. The proposed procedures include the following pertinent conditions:

1. Sponsoring Firm's written supervisory procedures ("WSPs") shall be amended to incorporate by reference these heightened supervisory procedures. The WSPs shall also be amended to state that Proposed Supervisor is Sponsoring Firm.'s registered principal in charge of supervising sales and trading. Employee 2 is Sponsoring Firm's registered principal in charge of supervising research.[5] Employee 1 is Sponsoring Firm's Chief Financial and Compliance Officer and a registered principal.[6] While X will not be permitted to open accounts or enter client orders, and will only be acting to introduce potential accounts to Sponsoring Firm, Proposed Supervisor will be X's primary supervisor responsible for X's oversight;

2. X shall not act in a supervisory capacity nor hold any supervisory (principal) level licenses while registered at Sponsoring Firm;

3. X shall be required to work in Sponsoring Firm's Office of Supervisory Jurisdiction;

4. Correspondence:

    a. *Supervisory Procedure*: Proposed Supervisor and/or Employee 1 shall review all of X's incoming and outgoing written correspondence, including all paper correspondence, facsimiles, e-mail communications and instant messaging. Proposed Supervisor and/or Employee 1 shall use Sponsoring Firm's third party service

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[5] CRD shows that Employee 2 has been registered with Sponsoring Firm since January 1999. He qualified as a general securities representative in 1995 and as a general securities principal in 1999. He has no disciplinary history.

[6] CRD shows that Employee 1 registered with Sponsoring Firm in December 2002. He qualified as a general securities representative in 1986 and as a general securities principal in 2007. He has no disciplinary history.

provider auditing program to review all e-mails and instant messaging;

b. *Frequency of Procedure*: Such review shall be conducted daily;

5. Outside Business and Outside Brokerage Accounts:

   a. *Supervisory Procedure*: Pursuant to NASD Rules 3030, 3040 and 3050, upon registration with Sponsoring Firm, and upon any occurrence of the following, but no less than quarterly thereafter regardless of the existence of updated information, X shall disclose to Sponsoring Firm and Proposed Supervisor pursuant to Rule 3030, all outside business activity; pursuant to Rule 3040, all outside business activity in the securities or investment banking industry; and pursuant to Rule 3050, all outside brokerage accounts subject to such rule;

   b. *Supervisory Procedure*: Sponsoring Firm shall have the discretion to approve or deny the opening of such accounts or the assuming of such outside business activities not known to Sponsoring Firm prior to X's registration with Sponsoring Firm, and under all circumstances shall require duplicate statements and confirms be sent to Sponsoring Firm.

   from the executing broker-dealer respecting all accounts falling under NASD Rule 3050;

6. At all times when Proposed Supervisor is out of the office, X shall be supervised by a supervisor designated by Proposed Supervisor and such designated supervisor hierarchy shall begin with Employee 2 and then proceed to Employee1 and then other registered personnel maintaining the appropriate supervisory licenses. Under no circumstances shall these heightened supervisory procedures be modified in any manner due to the temporary absence of Proposed Supervisor. All designated supervisors shall be subject to the same review procedures and timetables as Proposed Supervisor;

7. Sponsoring Firm shall require that X alert Sponsoring Firm and Proposed Supervisor to all investor complaints pertaining to X whether <u>verbal</u> or written. Proposed Supervisor shall subsequently prepare a complaint memorandum as to what measures Proposed Supervisor took to investigate the merits of the complaint (e.g., contact with the investor) and the resolution of the matter;

8. Proposed Supervisor shall certify to Sponsoring Firm quarterly that Proposed Supervisor and X are in compliance with all of the above conditions of heightened supervision respecting X. Such quarterly certifications shall be made a part of Sponsoring Firm's NASD Rule 3013 Annual Office Business Inspection Report;

9. Should Sponsoring Firm or Proposed Supervisor find that X has violated or intends to violate any NASD rules or the provisions of these Heightened Supervisory Procedures, Sponsoring Firm or Proposed Supervisor shall take immediate internal disciplinary action. Such violation or intended violation shall be grounds for immediate termination of X's registration and employment with ISI and shall be at Sponsoring Firm's sole discretion;

Internal Research and Sales

10. *Discretionary Accounts*: Without regard to whether Sponsoring Firm allows the establishment of discretionary accounts (currently it does not) X shall not maintain discretionary accounts at any time;

11. *Pre-Approval of New Accounts*: X shall pre-approve any client contact for opening an account. Proposed Supervisor shall review and pre-approve the opening of each new securities account, prior to such opening by Sponsoring Firm. Proposed Supervisor shall evidence such approval by signing or initialing, and dating all account opening documents. X shall not be the contact on any account. Proposed Supervisor will approve and control any X introduced account. Copies of all such documents shall be maintained at Sponsoring Firm's office;

12. *Order Entry Restriction*: Proposed Supervisor shall generate orders and execute all orders on any account opened or introduced by X. Proposed Supervisor shall evidence his review by signing or initialing the order documentation, such as order blotters or any other documentation reflecting same;

13. *Further Restrictions on Sales Communications with Institutional Clients*: X shall be restricted from communicating with any client of Sponsoring Firm respecting any security Sponsoring Firm is permitted to transact business in unless and until such security is approved by Proposed Supervisor and is entered into an "Approved Securities List." Proposed Supervisor shall evidence such approval on the "Approved Securities List" by signature and initial, and by dating, provided that this restriction shall not restrict X from communicating with clients who solicit information from X respecting securities that are not on the

Approved Securities List;

14. X's letter dated March 4, 2008, referencing "FINRA Rule 8210 Compliance Statement,"[7] certifies his understanding and agreement with Sponsoring Firm's amended proposed heightened supervisory procedures for X and his commitment to comply with Rule 8210.

## V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because: 1) X's statutorily disqualifying event is securities-related, serious, and very recent; 2) X has other disciplinary history; 3) the capacity in which the Firm proposes to employ X is in direct conflict with his disqualifying event; and 4) Proposed Supervisor may be considered unsuitable as a proposed supervisor due to the number and importance of his other roles within the Firm.

## VI. Discussion

After carefully considering the entire record in this matter, including the testimony and other evidence submitted at the hearing, we find that X's re-entry into the securities industry at this time would pose a serious risk to the investing public, and we therefore deny Sponsoring Firm's Capital's Application to employ X as a general securities representative.

### A. Sponsoring Firm Has Not Made the Strong Showing Necessary for the NAC to Approve X's Re-Entry to the Securities Industry Despite the NAC's Recent Imposition of an Unqualified Bar on X

#### 1. *The Standard*

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[7] X's 2008 letter states that he agrees "to comply with the restrictions, record handling, supervisory, and other operational procedures" contained in the proposed heightened supervisory procedures. It also states that he "understand[s] that FINRA does not have the authority to issue subpoenas, and that requiring FINRA to seek a subpoena or allowing individuals registered with FINRA the right to object to its informed (sic) request, or to seek independent review of its information requests, would create an obstacle to FINRA's ability to conduct its enforcement investigations, and would therefore be counter to the public's interest." Further, X asserts that he understands "that FINRA has no procedures for a member to request a review of its information requests" and that he understands and "agree[s] that any attempt to structure the activities of a FINRA member in a matter (sic) that interferes with the member's responsibility to provide FINRA with any records or information that becomes the subject of a FINRA information request would result in a violation of FINRA Rule 8210 if such information is not provided to the satisfaction of FINRA."

X is statutorily disqualified due to the NAC's imposition on him of an unqualified bar in August 2006—the NAC's most serious sanction. We have previously noted, in several earlier statutory disqualification cases involving unqualified FINRA imposed bars, that "[b]ars are intended to prohibit completely a person's ability to engage in any future securities business with any member firm, thus precluding re-entry into the securities industry absent extremely unusual circumstances." *See The Ass'n of X as a Gen. Secs. Representative*, Redacted Decision No. SD01016 (2001), at 4, *available at* *http://www.finra.org/web/groups/enforcement/documents/nac_stat_dq_decisions/p011593.pdf*; *The Ass'n of X as an Inv. Co. and Variable Contracts Products Representative*, Redacted Decision No. SD99023 (1999), at 3, *available at* *http://www.finra.org/web/groups/enforcement/documents/nac_stat_dq_decisions/p012616.pdf*. Thus, a FINRA-barred applicant is required to make an extremely strong showing for us to find that approval of an application for re-entry would serve the public interest. *The Ass'n of X as an Inv. Co. and Variable Contracts Products Representative*, Redacted Decision No. SD99023 at 3. Particularly given the circumstances under which the NAC imposed the unqualified bar on X, we find that Sponsoring Firm has not made the strong showing necessary for our approval of its Application for X to re-enter the securities industry. *See Gershon Tannenbaum*, 50 S.E.C. 1138, 1140 (1992) ("In NASD proceedings . . ., the burden rests on the applicant to show that, despite the disqualification, it is in the public interest to permit the requested employment."); *M.J. Coen*, 47 S.E.C. 558, 561 (1981) ("[A]ny member wishing to employ such a [statutorily disqualified] person . . . must 'demonstrate why the application should be granted.'").

2. *X Knowingly Failed to Respond to Numerous FINRA Requests for Information and Deliberately Impeded an Important Ongoing Investigation*

FINRA began its investigation of X in 2003[8] to determine whether he and Firm 1 had complied with NASD's Rule 2711 governing the public dissemination of six research reports about Firm 5. In an earlier Notice to Members, FINRA noted the importance of NASD Rule 2711, stating that it was intended "to improve the objectivity of research and provide investors with more useful and reliable information when making investment decisions" and "to restore investor confidence in a process that is critical to the equities markets." *NASD Notice to Members 02-39* (July 2002).

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[8] FINRA's investigation of X and Firm 1 stemmed from a general review conducted by FINRA's Department of Enforcement ("Enforcement") of industry compliance with NASD Rule 2711.

At the time of FINRA's investigation, X was registered with Firm 1 in numerous capacities: general securities representative (Series 7), general securities principal (Series 24), financial and operations principal (Series 27), municipal securities representative (Series 52), municipal securities principal (Series 53), registered options principal (Series 4), and equity trader (Series 55). As such, X was entrusted to comply with the rules and regulations that govern the securities industry. Yet he willfully disregarded that obligation by failing, on numerous occasions, to respond to FINRA's Rule 8210 requests for information during its investigation into the Firm 5 reports and whether they contained misleading facts or omitted required information. X acknowledged at the hearing in this matter that he made the choice to refuse to comply with FINRA's requests for information.[9] X further acknowledged at the hearing that he realized at the time of FINRA's investigation that his purposeful and explicit disregard of FINRA's rules could lead to a bar, particularly because his failure to respond could impede the progress of FINRA's ongoing investigation of the questionable Firm 5 reports.

Indeed, following the disciplinary hearing brought by Enforcement against X and Firm 1, FINRA's Office of Hearing Officers issued a decision ("the OHO decision") finding that "[t]he evidence conclusively establishes that X purposefully impeded NASD's investigation by refusing to provide information about the Firm 5 [research] reports and the relationship between 1A and Firm 1." [Case Redacted]. Additionally, after X appealed the OHO decision to the NAC, the NAC issued a decision in July 2006 finding that "X failed to respond to numerous questions that were at the heart of NASD's investigation into respondents' compliance with Rule 2711(h)." [Case Redacted].

X's prior violations are further compounded at this stage, moreover, because at the hearing in this matter X admitted that, in addition to refusing to provide the requested information to FINRA, he had lied under oath during the OHO proceeding when he denied that he was involved in the writing or posting of the Firm 5 research

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[9] X provided evidence, including a letter from a psychiatrist, to argue that he had responded aberrationally and irrationally to FINRA's requests for information in 2003 because he was debilitated by highly stressful problems, including multiple litigations, the serious illness of his mother, and personal anger management issues. We do not consider this evidence as an attempt to excuse the misconduct for which the NAC barred X in 2006, as such would constitute an impermissible collateral attack on the underlying previously litigated statutorily disqualifying event that brings X before us now. *See Joseph Frymer*, 49 S.E.C. 1181, 1182 (1989). To the extent that X argues that such evidence proves that he has rehabilitated himself and will no longer be a threat to the investing public, we address this evidence in further detail below.

reports.[10] This new admission by X shows that he did everything within his power to obstruct FINRA's attempts to gather information concerning potentially misleading research reports. X testified at the hearing in this matter that he should have admitted his role in preparing the reports in question. This late admission, however, does not absolve X of his responsibility for having purposefully impeded FINRA's investigation of the inadequacy of the Firm 5 research reports and their potential damaging effect on the investing public.

Accordingly, X's failure to respond to FINRA's requests for information demonstrated a wanton disregard for FINRA's regulatory authority and impeded an important investigation. In deciding to impose an unqualified bar on X, the NAC also considered that X had a disciplinary history that aggravated his misconduct. The NAC noted FINRA's 2000 AWC against X, which sanctioned X and Firm 1 for "violations of rules governing communications with the public and customers, including failing to disclose the risks associated with short selling, omitting material facts, making misleading statements, and referring to past recommendations without setting forth all relevant past recommendations." [Case Redacted]. The NAC also noted that FINRA imposed serious sanctions on X for this misconduct—a joint and several fine of $75,000, a requirement to remove and refile with FINRA all firm advertisements, and a requirement for X to requalify as a general securities principal. Thus the NAC concluded that the "nature of X's past misconduct, which evidenced disregard for regulatory requirements and investor protection, warrants the more serious sanctions that we impose on recidivists." [Case Redacted].

Given the seriousness of X's misconduct, aggravated by his relevant disciplinary history, the NAC was fully warranted in imposing an unqualified bar on X. FINRA's primary means of obtaining information in investigations is to compel the production of information by FINRA members and associated persons via NASD Rule 8210. *Cf., e.g.*, *Charles R. Stedman*, 51 S.E.C. 1228, 1232 (1994) (affirming bar on registered representative for failure to comply with NASD Rule 8210). "To allow associated persons to 'flout' [NASD Rule 8210] would 'subvert the NASD's ability to carry out its regulatory responsibilities.'" *Jonathan Garret Ornstein*, 51 S.E.C. 135, 141 (1992) (*quoting Daniel C. Adams*, 47 S.E.C. 919, 922 (1983)). We will not

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[10] In fact, during the OHO proceeding, instead of admitting his role in the preparation of the Firm 5 reports in question, X spun an incredible story of sending e-mails regarding thoughts and information about Firm 5 to an unnamed person at the firm, and not knowing who of the three firm employees (himself and two others) opened the e-mails, wrote the reports, or posted the reports. The NAC found X's testimony in this regard not credible, and noted that even X's counsel conceded at oral argument before the NAC Subcommittee that "I think it comes out clearly that [X] was the one who provided the substance of the reports." [Case Redacted].

disturb such a bar in the absence of the requisite strong showing of exceptional circumstances, which we do not find in Sponsoring Firm's Application.

3. *The NAC Imposed an Unqualified Bar on X Very Recently*

Moreover, the NAC imposed its most serious sanction on X on July 28, 2006. Simply put, X served his bar only 14 months before Sponsoring Firm filed its MC-400 in this matter, and only 20 months before he appeared at the hearing before the Hearing Panel. Given the reasons for the NAC's imposition of the bar on X, and the fact that he has previously exhibited an inability to follow securities rules and regulations, we conclude that insufficient time has elapsed for X to demonstrate his willingness or ability to operate responsibly in the securities industry.

4. *X Has a Regulatory History*

Since 1994, FINRA has filed four formal regulatory actions against X. Each of these actions demonstrates X's tendency to ignore regulatory authority and pursue his own course of action.[11] The record shows that X opened his own firm, Firm 1, in 1993, after previously having been employed for various brief periods at 14 different firms between 1982 and 1992. Shortly thereafter, in 1994, FINRA issued X and the firm their first AWC for failing to obtain an amendment to the firm's restriction agreement with FINRA.

The second AWC followed in 1998, when FINRA found that X and Firm 1 had failed to develop and maintain a written training plan and a continuing and current education program for its registered persons in 1996 and 1997.

Finally, in 2000, FINRA accepted another AWC from X and Firm 1for a myriad of issues, including short selling violations, trade reporting violations, advertising violations, and supervision violations. At that time, FINRA not only imposed a serious joint and several fine of $75,000, but also required the firm to retain

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[11] X's counsel argued at the hearing that the three FINRA formal actions that occurred prior to the 2006 bar are not separate statutorily disqualifying events, and thus should not be held against X in considering this Application. While it is true that these events alone do not constitute statutorily disqualifying offenses, we are obligated to consider X's full disciplinary history in assessing his current Application to return to the securities industry and whether he presents a potential risk to the investing public. *See Tannenbaum*, 50 S.E.C. at 1141 (concluding that applicant's "serious misconduct" warranted denial of application).

an independent consultant and required X to requalify by examination as a general securities principal.

Although X did requalify as a general securities principal, he continued to break FINRA's rules by refusing to cooperate with regulatory authorities. He admittedly defied FINRA's 2003 requests for information regarding Firm 5 and his own actions in connection with Firm 5's research reports during FINRA's investigation. During the course of that proceeding, X repeatedly argued that FINRA lacked jurisdiction over him, and attempted to substitute his own judgment for that of FINRA's in requesting information. X freely elected to disregard FINRA's rules, and he chose to second guess FINRA's authority and need for information in direct violation of his unequivocal obligation to cooperate with FINRA. *See Michael J. Markowski*, 51 S.E.C. 553, 557 (1993) (finding that associated persons must provide information upon FINRA's request, even if they have contrary belief as to the appropriateness of the request), *aff'd*, 34 F.3d 99 (2d Cir. 1994).

Given X's extensive and lengthy history of proven lack of compliance with FINRA rules, we give little weight to his arguments regarding his alleged reformation of character[12] and newly found respect for regulatory authority.[13] X introduced evidence indicating that he voluntarily completed a 12-week anger management program, and that he has continued individual treatment with the same psychotherapist. X also introduced a letter dated February 4, 2008, from a forensic psychiatrist who met with him nine times between March 2007 and February 2008. The forensic psychiatrist's letter discussed various theories for X's "anger" at FINRA during the period of the Firm 5 investigation (including the serious illness of X's mother, and numerous litigations pending against him as a result of his short selling activities). The letter also stated that X's past behavior "represents an isolated event" and that X does not "suffer from any condition that merits concern regarding his professional functioning." We note that the letter carefully qualifies the psychiatrist's opinion and does not represent to a certainty that X will not engage in unprofessional

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[12] In addition to seeking medical advice, X asserted that he has changed his religion, practices meditation, and now sees the world through the more responsible eyes of a new father of a three-year-old daughter.

[13] As we noted earlier, we do not consider the psychiatric evidence as "mitigation" in connection with the NAC's 2006 decision to impose an unqualified bar on X. This would constitute an impermissible collateral attack on a final NAC action. *See Frymer*, 49 S.E.C. at 1182. We only consider it here because X has asserted this evidence to argue that he has reformed his bad character traits and now presents no threat of harm to the regulatory authority of FINRA or to the investing public.

conduct. Moreover, there is no indication that the forensic psychiatrist was made aware of X's full disciplinary history as the letter does not discuss X's three AWCs prior to the events that led to the 2006 bar, which shows that his authority-flouting behavior in 2003 was hardly an "isolated event" or aberrational behavior that only occurred during a short period of time.[14]

We also reject X's argument that FINRA should permit him to re-enter the securities industry because his past activities in securities analysis were of material value to the investing public's price discovery processes. We do not, however, assign a greater or lesser value to the securities activities in which an applicant has engaged prior to the disciplinary event that led to an unqualified bar. We are more narrowly focused on X's history of misconduct and the reliabiliy of his claim of an unwavering commitment to the rules and regulations of the industry. We do not find X's assurances to meet the high standard required. *See Morton Kantrowitz*, 52 S.E.C. 721, 723 (1996) (rejecting argument that applicant's offers of assistance to various state and federal regulators and FINRA in their investigations of securities-related misconduct warranted his readmission). Moreover, the record shows that X acted to further his own interests and ignored regulatory authority in pursuit of those interests. X was admittedly a professional short seller. He uncovered stock fraud and profited therefrom by selling the stock short, making the fraud public, and attempting to buy the stock back when its price dropped. Thus, X's motive in providing his prior public securities analyses was hardly altruistic.

B. Sponsoring Firm's Proposed Supervisory Structure for X Is Inadequate

Next, we consider the nature and disciplinary history of Sponsoring Firm and the proposed supervisory structure for X. We note that the Firm has no formal disciplinary history, and that the proposed primary supervisor, Proposed Supervisor, is well qualified and has no disciplinary history. This lack of disciplinary history, however, does not outweigh our very serious concerns, as stated above, about returning X to the securities industry even if he is subject to intensive supervision.

Further, we do have some concerns with the Firm's proposed supervisory procedures. *See Citadel Sec. Corp.*, 2004 SEC LEXIS 949, at *13 (May 7, 2004) ("[I]n determining whether to permit the employment of a statutorily disqualified person, the quality of the supervision to be accorded that person is of utmost importance. We have made it clear that such persons must be subject to stringent oversight by supervisors who are fully qualified to implement the necessary controls.") (internal quotation omitted). Although Proposed Supervisor has no

[14] Instead, the letter relied on X's representations that he had no customer complaints in more than 20 years and had not previously failed to comply with NASD Rule 8210.

disciplinary history, he does have several prominent positions at the Sponsoring Firm, including managing member, chief compliance officer, and president. He also currently directly supervises four other individuals. When the Sponsoring Firm became aware of Member Regulation's objection to Proposed Supervisor's role as primary supervisor due to his other activities, the Sponsoring Firm attempted to revise its proposal to name two other individuals, Employee 2 and Employee 1, as "back-up" supervisors. The revised proposed structure, however, is fragmented and does not place the primary daily responsibility for X squarely in the hands of one capable and available supervisor. We find inadequate the revised proposed structure's reliance on Employee 1, who currently has supervisory responsibilities for seven other registered representatives and only became a general securities principal in 2007.

Moreover, although the Sponsoring Firm has presented the beginning of a draft of proposed supervisory procedures, it has not presented us with a final proposal that we find to be adequate.[15] X's history suggests that he is a person who is accustomed to being in charge of operations and not one who submits willingly to the authority of others. The proposed procedures do not convince us that the Sponsoring Firm will be able to exercise the necessary control over X's activities. For example, there is no provision covering supervision of X in meetings with clients outside of the office, or in his outside e-mail or instant messaging correspondence. The Sponsoring Firm also proposes to have X involved in the preparation of research reports, an area in which the NAC previously found his work to be violative and misleading to the public. Although the Sponsoring Firm argues that X will not publicly disseminate his reports, the plan is for others in the Sponsoring Firm to use X's research, and presumably they will be able to communicate aspects of that research to customers. Finally, we are not persuaded that X does not present a threat to the investing public because he attached a separate letter to the proposed supervisory procedures stating that he recognizes the importance of NASD Rule 8210 and will comply with it at all times in the future. Simply stating that one will comply with rules is not sufficient—all associated persons are obligated to follow the rules of the industry. We look instead to the entire record of X's interactions with FINRA throughout the years. Given X's regulatory history and his demonstrated propensity to flout regulatory authority, we do not find the proposed supervisory structure acceptable to govern X's activities.

## VII. Conclusion

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[15] The Sponsoring Firm stated at the hearing that it would agree to amend its proposal to include reasonable supervisory procedures suggested by Member Regulation or the NAC. The burden is on the applicant in a statutory disqualification proceeding, however, to present its best evidence to demonstrate that the association of the proposed individual would be in the public interest. *See Tannenbaum*, 50 S.E.C. at 1140. We find that the Sponsoring Firm has not done so in this instance.

Accordingly, we find that it is not in the public interest, and would create an unreasonable risk of harm to the market or investors, for X to become associated with Sponsoring Firm as a general securities representative. We therefore deny the Application.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith
Senior Vice President and Corporate Secretary