

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of

X<sup>1</sup>

as an

Associated Person

with

The Sponsoring Firm

Redacted Decision

Notice Pursuant to

Rule 19h-1

Securities Exchange Act  
of 1934

SD08006

Date: 2008

**I. Introduction**

In November 2007, the Sponsoring Firm submitted a Membership Continuance Application (“MC-400” or “the Application”) with the Department of Registration and Disclosure at the Financial Industry Regulatory Authority (“FINRA”). The Application seeks to permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm. A hearing was not held in this matter. Rather, pursuant to NASD Rule 9523, FINRA’s Department of Member Regulation (“Member Regulation”) recommended that the Chair of the Statutory Disqualification Committee, acting on behalf of the National Adjudicatory Council, approve X’s proposed association with the Sponsoring Firm pursuant to the terms and conditions set forth below.

For the reasons explained below, we approve the Sponsoring Firm’s Application.

**II. The Statutorily Disqualifying Event**

In December 1998, the Securities and Exchange Commission (“the Commission”) issued an Order Making Findings, Imposing Remedial Sanctions and Cease-and-Desist Order (“the 1998 SEC Order”) against X, fining him \$50,000 and barring him from associating with any broker-dealer with the right to reapply after five years. The 1998 SEC Order found that X engaged in fraudulent conduct with respect to the offering of Fund 1. The 1998 SEC Order further found that X made material misrepresentations to an investor and other potential investors about Fund 1, and that he distributed false and misleading marketing materials.

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<sup>1</sup> 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.

### **III. Background Information**

#### **A. X**

X first registered in the securities industry as an investment company and variable contracts products limited representative (Series 6) in December 1990. He requalified for the Series 6 in January 2005. He also qualified as a uniform securities agent state law (Series 63) in March 1991 and requalified in February 2005.

X was previously associated with six other firms from 1985 until 1999. From 1999 until 2004, X served as the chief executive officer of Firm 1, an internet identity authentication company that he co-founded. Since 2004 he has been employed in a variety of positions, primarily in the information technology and telecommunication fields.

We are not aware of any other disciplinary or regulatory proceedings, complaints, or arbitrations against X.

#### **B. The Sponsoring Firm**

The Sponsoring Firm became a FINRA member in September 2000. The Sponsoring Firm's MC-400 represents that it has one office of supervisory jurisdiction and no branch offices. The Sponsoring Firm also represents that it employs one registered principal and one registered representative, and that it is engaged as a "mutual fund retailer" and in "solicitation activities with respect to separately managed accounts, mutual funds, private investment funds and other collective investment vehicles."

FINRA conducted two routine examinations of the Sponsoring Firm in 2001 and 2005. After the 2001 examination, FINRA issued the Firm a Letter of Caution ("LOC") for failing to accurately compute its net capital on one occasion. The Sponsoring Firm responded by letter dated September 2001, stating that it had corrected the noted deficiency.

FINRA found no deficiencies in its 2005 routine examination of the Sponsoring Firm.

FINRA also conducted a cause examination of the Sponsoring Firm in 2002 and issued the Firm an LOC for failing to prevent an inactive registered person from engaging in securities activities, and failing to follow written supervisory procedures. The Sponsoring Firm responded in a letter dated June 2002, stating that it had corrected the noted deficiencies.

We are not aware of any other complaints, disciplinary proceedings, or arbitrations against the Sponsoring Firm.

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

The Sponsoring Firm proposes to employ X in a non-registered capacity as a consultant to broker-dealers and other financial services institutions with respect to developing and marketing

exchange traded funds (“ETFs”).<sup>2</sup> X will not have any involvement in securities sales activities. In his position as a consultant, the Sponsoring Firm proposes that X will render his services in three stages:

1. X will consult with clients regarding the strategic development of a product, including selecting the product niche, e.g., fixed income, equity, subadvised products, and wrap products. For subadvised products, X will consult regarding selection of a “subadvisor” to assist the ETF sponsor in developing the ETF’s investment strategy;
2. X will assist with the retention of key service providers. X will consult with the client concerning requests for proposals for legal counsel to obtain any necessary exemptive order or other regulatory approval, as well as requests for proposals to identify the best administrator, custodian, specialist firm and any other necessary vendors; and
3. X will work with the client and the client’s legal counsel to obtain the necessary exemptive order or prepare any registration statement or other regulatory filings required to obtain all necessary regulatory approvals.

The Sponsoring Firm also represents that it will compensate X on a fee-based arrangement. When X acts as a consultant, the Sponsoring Firm will pay him 80% of the fees received from the client, while the Sponsoring Firm receives the remaining 20%.

The Sponsoring Firm proposes that X will be based out of his home in City 1, State 1, and that he will be supervised off-site by the Proposed Supervisor, the Sponsoring Firm’s president. The Proposed Supervisor first registered as an investment company and variable contracts products limited representative in December 1985. He qualified as an investment company and variable contracts products limited principal (Series 26) in January 1994.

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

#### **V. Member Regulation’s Recommendation**

Member Regulation recommends approval of the Sponsoring Firm’s request for X to associate with the Sponsoring Firm in a non-registered capacity, subject to the terms and conditions of heightened supervision listed below.

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<sup>2</sup> Member Regulation confirms that X need not be registered to perform his proposed activities with the Sponsoring Firm.

## VI. Discussion

After carefully reviewing the entire record in this matter, we approve the Sponsoring Firm's Application for X to associate with the Sponsoring Firm in a non-registered capacity, 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 *Paul Edward Van Dusen*, 47 S.E.C. 668 (1981) and *Arthur H. Ross*, 50 S.E.C. 1082 (1992). *Van Dusen* and *Ross* provide 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 Securities Exchange Act of 1934 ("Exchange Act") and unfair to deny an application for re-entry. *Van Dusen*, 47 S.E.C. at 671.

The Commission also noted in *Van Dusen*, however, that an applicant's re-entry is not "to be granted automatically" after the expiration of a given time period. *Id.* Instead, the Commission instructed FINRA to consider other factors, such as: 1) other misconduct in which the applicant may have engaged; 2) the nature and disciplinary history of the prospective employer and supervisor; and 3) the supervision to be accorded the applicant. *Id.*

### B. Application of the *Van Dusen* Standards

After applying the *Van Dusen* standards to this matter, we have determined to approve the Sponsoring Firm's Application.

First, the record shows that X has no intervening misconduct. He has no complaints, regulatory actions, or criminal history since the 1998 SEC Order. Since December 1998, X has been employed in a variety of positions, primarily in the information technology and telecommunication fields, without incident.

Second, we note that the Proposed Supervisor is well qualified. He has been in the securities industry since 1985 without any disciplinary history, and he has been an investment company and variable contracts products limited principal since 1994.

Third, we look to the nature and disciplinary history of the Sponsoring Firm and to the plan of supervision. We note that the Sponsoring Firm has no formal disciplinary history and that it has proposed a comprehensive supervisory plan to ensure that it will be able to maintain future compliance with the plan of heightened supervision for X.

We are satisfied that the following heightened supervisory procedures will enable the Sponsoring Firm to reasonably monitor X's activities on a regular basis:<sup>3</sup>

1. \*The Sponsoring Firm will amend its supervisory procedures to clearly specify that the Proposed Supervisor is the responsible supervisor for X;
2. \*X will act only in an associated capacity and will not be a registered representative of the Sponsoring Firm;
3. \*X will have a dedicated phone line. The Proposed Supervisor will have access to X's phone at all times, due to X's line being accessible from the Proposed Supervisor's phone. The Proposed Supervisor will have the ability to listen in on X's calls at any time by merely picking up the phone. For audit and compliance purposes, the Proposed Supervisor will randomly listen in on X's phone line, at least twice a week. The Proposed Supervisor will listen in on the complete phone call, from beginning to end. If the Proposed Supervisor finds that any aspect of the call is not in compliance with X's stated duties, the Proposed Supervisor will record his findings in a memorandum and present those findings to a FINRA examiner during the next statutory disqualification examination of X. The Proposed Supervisor will maintain a log of the telephone calls, review it on a monthly basis to ensure that X's calls are in compliance with his stated responsibilities, and keep the log segregated for ease of review;
4. \*The Proposed Supervisor will review and approve all of X's incoming paper correspondence upon its arrival. All of X's incoming paper correspondence will first be received by the Proposed Supervisor, at the Sponsoring Firm's home office, and then forwarded to X. X's outgoing paper correspondence will be reviewed by the Proposed Supervisor before it is sent. X will forward all outgoing paper correspondence to the Proposed Supervisor and await his response before sending it. X will keep a record of all of his outgoing paper correspondence and will keep a copy for ease of review during the Proposed Supervisor's random examination. The Proposed Supervisor will keep a written record evidencing his review of all of X's paper correspondence;
5. \*For the purposes of client communication, X will only be allowed to use an email account that is held at the Sponsoring Firm. With respect to emails, the Proposed Supervisor will have immediate access to all email communications on X's Sponsoring Firm email account, which are either sent or received by X. If X receives a business related email message in another email account outside the Sponsoring Firm, he will immediately deliver that message to the Sponsoring Firm's email account. X will also inform the Sponsoring Firm of all outside email accounts that he maintains. The Proposed Supervisor will conduct a weekly review of all email messages that are either

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<sup>3</sup> The items that are denoted by an asterisk are heightened supervisory conditions for X and are not standard operating procedures of the Sponsoring Firm.

- sent or received by X and will preserve the email messages in electronic format, and keep them segregated for ease of review;
6. \*The Proposed Supervisor will review and approve all of X's client agreements before they are entered into by X. To evidence review, the Proposed Supervisor will make copies of the agreements, initial them, and keep the copies segregated for ease of review;
  7. \*X will conduct all of his client communications via the Sponsoring Firm-issued electronics, including but not limited to cell phones, facsimile machines, and computers;
  8. \*The Proposed Supervisor will have access to X's work calendar, and X will inform the Proposed Supervisor of the date, time, and location of all of X's outside client appointments. X will be responsible for entering all meetings into his meeting calendar to ensure that the Proposed Supervisor is aware of them when reviewing the work calendar. X will keep a log of all of the meetings that he enters on his calendar for ease of review;
  9. \*X will not accept any customer funds or securities;
  10. \*X will not supervise any other Sponsoring Firm employees;
  11. \*If the Proposed Supervisor is to be on vacation or out of the office for more than one week, he will call X at least once during the second week. X will not be permitted to negotiate any client agreements in the Proposed Supervisor's absence, unless the Proposed Supervisor is able to review and approve the agreement remotely. If the Proposed Supervisor is in a position to review the agreement remotely, he will preserve a copy of the agreement with his initials and keep it segregated for ease of review. X will not send any written correspondence in the Proposed Supervisor's absence, without the Proposed Supervisor's approval. If X is able to send correspondence by facsimile and obtain the Proposed Supervisor's approval, he will be permitted to send the written correspondence. No correspondence that is received during the Proposed Supervisor's absence will be forwarded to X;
  12. \*The Proposed Supervisor will visit with X once every three weeks, in person, to ensure that X is in compliance with the terms and conditions of the heightened plan of supervision. The Proposed Supervisor will maintain a log of these meetings and keep it segregated for ease of review; and
  13. \*The Proposed Supervisor must certify quarterly (March 31, June 30, September 30, and December 31) that he and X are in compliance with all of the conditions of heightened supervision to be accorded X.

FINRA certifies that: 1) X meets all applicable requirements for the proposed employment; 2) the Firm represents that it is not a member of any other self-regulatory organization; 3) The Proposed Supervisor and X represent that they are not related by blood or marriage; and 4) the Sponsoring Firm represents that it does not employ any other statutorily disqualified individuals.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the association of X in a non-registered capacity with the Sponsoring Firm will become effective upon the issuance of an order by the Commission that it will not institute proceedings pursuant to Section 15(b) of the Exchange Act and that it will not direct otherwise pursuant to Section 15A(g)(2) of the Exchange Act. This notice shall serve as an application for such an order.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith  
Senior Vice President and Corporate Secretary