BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X[1] as a General Securities Representative/ Compliance Officer with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 SD09003 Date: 2009

I. Introduction

In July 2008, the Sponsoring Firm submitted a Membership Continuance Application ("MC-400" or "the Application") with the Financial Industry Regulatory Authority's ("FINRA") 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, acting only in the capacity of a compliance officer. In February 2009, a subcommittee ("Hearing Panel") of FINRA's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, accompanied by the Sponsoring Firm's vice president and chief compliance officer, the Proposed Supervisor. FINRA Employee 1, FINRA Attorney 1, and FINRA Attorney 2 appeared on behalf of FINRA's Department of Member Regulation ("Member Regulation").

For the reasons explained below, we deny the Sponsoring Firm's Application.[2]

[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] 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").

Following the consolidation of NASD and the member regulation, enforcement and arbitration functions of NYSE Regulation into FINRA, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See FINRA Regulatory Notice 08-57* (Oct. 2008). Because this matter involves an MC-400 that was filed before December 15, 2008, we apply the procedural rules that were in effect at the time, the NASD Rule 9520 Series.

II. The Statutorily Disqualifying Event

X is statutorily disqualified because in January 2007, he pled guilty to two counts of "online solicitation of a minor to meet with the intention of sexual contact," a felony in State 1.[3] In pre-hearing submissions and in testimony at the hearing, X stated that he had conducted online conversations with the young woman in question for several months in 2005, but had never met her.[4] He agreed to meet her at a hotel in November 2005. When he arrived at the hotel, however, he was arrested by several police officers, who had been notified by the young woman's mother.

Following X's guilty plea, the State 1 court sentenced him to 180 days in county jail for each count (one sentence beginning March 2007, and the other beginning August 2007) and 10 years of "community supervision" (a probation-like status that also requires 180 hours of community service at 10 hours per month). The court also required him to register as a sex offender. X served the two jail sentences, registered as a sex offender, and has served two of his required 10 years of community supervision.

III. Background Information

A. X

From January 1994 until August 2001, X served in the United States Marine Corps and worked in non-registered but fingerprinted capacities for Firm One from May 2000 until December 2000, and Firm Two from January 2001 until June 2001. He also worked as an NASD examiner in FINRA's State 1 district office from April 2003 until November 2004.

X first registered in the securities industry as a general securities representative (Series 7) in January 2005 with Firm Three. X requalified as a general securities representative in June 2008. He also qualified as a general securities principal (Series 24) in March 2005 and requalified in that capacity in July 2008.

Firm Three discharged X in November 2005. The Uniform Termination Notice for Securities Industry Registration filed by Firm Three states the reason for X's termination as "Discharge" and "Not Compliance Related." X testified that Firm Three discharged him due to his 2005 felony arrest.

---

[3] X testified that he was charged with one felony for the county in which he was arrested, and another felony for the county in which the young woman resided.

[4] In a pre-hearing submission, X stated that he was "at the end of a failing marriage" and that the young woman "initially claimed to be of majority age." We do not consider this evidence as an attempt to excuse the misconduct to which X pled guilty in January 2007, 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).

Since his discharge from Firm Three, X was employed as a Walmart manager from November 2005 until February 2007, and has worked as an independent contractor compliance consultant.

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

B. The Sponsoring Firm

The Sponsoring Firm is based in City 1, State 2. It became a FINRA member in October 1983. The Sponsoring Firm's business includes selling mutual funds, acting as a municipal securities dealer, selling variable life insurance or annuities, and performing investment advisory services. It represents that it has 300 branch offices and employs 85 registered principals and 387 registered representatives.

FINRA has not yet completed its 2008 routine examination of the Sponsoring Firm. Between 2002 and 2006, FINRA conducted several routine examinations and issued the Sponsoring Firm one Letter of Acceptance, Waiver and Consent ("AWC"), one Minor Rule Violation ("MRV"), and three Letters of Caution ("LOC").

FINRA's 2006 routine examination resulted in an AWC and an LOC. The AWC imposed a $5,000 fine on the Sponsoring Firm for failing to timely forward customer checks for payment of direct purchases of investment company shares and failing to maintain adequate check blotters. The LOC cited the Sponsoring Firm for numerous violations, including inadequate written supervisory procedures, failing to maintain an accurate business continuity plan, registration deficiencies, continuing education deficiencies, and—of particular significance here—failing to follow procedures regarding the review of a registered representative who was subject to heightened supervision.

FINRA issued an LOC to the Sponsoring Firm following its 2004 routine examination for several violations, including failing to capture and retain all Firm communications, books and records deficiencies, new account discrepancies, anti-money laundering ("AML") procedure inadequacies, and incorrect confirmations.

FINRA's 2002 routine examination led to the issuance of an MRV and an LOC. The MRV fined the Sponsoring Firm $2,500 for failing to report customer complaints in a timely manner. The LOC cited the Sponsoring Firm for registration violations, advertising violations, inadequate written supervisory procedures, and new account form deficiencies.

The record shows no 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 as a compliance officer/general securities representative, in the Sponsoring Firm's home office in City 1, State 2. The Sponsoring Firm

represents that X's responsibilities will be compliance related, including "branch office examinations, trade and email surveillance, customer complaint resolution, licensing and registration, AML and advertising review." The Sponsoring Firm states that X will be paid "salary plus a nominal bonus based on performance."

The Sponsoring Firm proposes that Proposed Supervisor will be X's primary on-site supervisor. The Proposed Supervisor is the Sponsoring Firm's vice president and chief compliance officer. FINRA's Central Registration Depository ("CRD"®) records indicate that the Proposed Supervisor is a "less than 5%" direct owner of the Sponsoring Firm.

The Proposed Supervisor first registered as a general securities representative in May 1994. He qualified as a general securities principal in April 1996. He has been associated with the Sponsoring Firm since April 2005. Prior to that time, he was associated with five different member firms between 1993 and 2005. The Proposed Supervisor currently supervises four individuals—three compliance specialists and one compliance administrator. The record shows no disciplinary history against the Proposed Supervisor, individually. Notably, however, FINRA's 2006 examination findings that resulted in an AWC and LOC against the Sponsoring Firm were made while the Proposed Supervisor was the chief compliance officer and thus charged with the ultimate responsibility of overseeing the Sponsoring Firm's compliance programs.

Following the hearing, the Sponsoring Firm proposed the following heightened supervisory procedures:[5]

1. The Sponsoring Firm will amend its written supervisory procedures to state that Proposed Supervisor is the primary supervisor responsible for X;

2. X will not maintain discretionary accounts;

---

[5] Prior to the hearing, the Sponsoring Firm's MC-400 proposed only the following minimal procedures:

1. The supervisor meeting with the SD on a periodic basis to review his performance. This will entail a review of his performance in the areas assigned to him. The Sponsoring Firm will keep a log of the findings of these meetings.

2. All customer, representative or staff complaints pertaining to the SD, whether verbal or written, will be immediately referred to the Director of Compliance. The 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. Documents pertaining to these complaints should be segregated for ease of review.

The Hearing Panel therefore requested that the Sponsoring Firm provide a post-hearing submission containing more detailed heightened supervisory procedures.

3. X will not act in a sales representative capacity. X will not meet with clients or handle customer funds;

4. When X is in the office, Proposed Supervisor will supervise him in the Sponsoring Firm's home office;

5. Proposed Supervisor will periodically review X's electronic communications, branch examinations, employee performance, and internet activity. Proposed Supervisor will document his review by affixing his signature to hard copies of the reviews and maintaining them in X's human resource file at the Sponsoring Firm's home office;

6. Proposed Supervisor will periodically review X's written correspondence;

7. On a monthly basis, X must disclose to Proposed Supervisor details related to his probation and must immediately notify Proposed Supervisor if he is in violation of any terms of his probation;

8. If Proposed Supervisor is on vacation or out of the office for an extended period, Secondary Supervisor, Director of Human Resources, will act as X's interim supervisor;[6]

9. All complaints pertaining to X, whether verbal or written, will be immediately referred to Proposed Supervisor for review. Proposed Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint (e.g., contact with the complaining party) and the resolution of the matter. Proposed Supervisor will keep documents pertaining to these complaints segregated for ease of review;

10. For the duration of X's statutory disqualification, the Sponsoring Firm will notify Member Regulation if it wishes to change X's responsible supervisor from Proposed Supervisor to another person; and

11. Proposed Supervisor must certify quarterly (March 31, June 30, September 30, and December 31) that X is in compliance with all of the above conditions of heightened supervision.

---

[6] FINRA's CRD shows that Secondary Supervisor has been associated with the Sponsoring Firm since April 1987. She qualified as an investment company/variable contracts limited representative (Series 6) in April 1988, and as an investment company/variable contracts limited principal (Series 26) in November 1993. She is not qualified as a general securities principal. She has no disciplinary history.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because: 1) the nature of X's disqualification is very serious and demonstrates a "severe lack of judgment, ethics, character and responsibility;" 2) X's conviction is recent; 3) X is currently subject to community supervision that will continue until 2017; and 4) the Sponsoring Firm has not proposed a plan of heightened supervision that provides adequate safeguards for an individual subject to a statutory disqualification.

VI. Discussion

A. The Standard

In reviewing this type of application, we consider whether the particular felony at issue, examined in light of the circumstances related to the felony, and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.[7] We assess the totality of the circumstances in reaching a judgment about X's future ability to work in the securities industry in a manner that comports with FINRA's requirements for high standards of commercial honor and just and equitable principles of trade in the conduct of his business.

For the reasons set forth below, we conclude that X's participation in the securities industry will present an unreasonable risk of harm to the market or investors, and we therefore deny the Sponsoring Firm's Application to employ X as a compliance officer/general securities representative.

B. X's Felony Conviction and Probation

First, we note that X was recently convicted of a very serious crime – online solicitation of a person under 18 to engage in a sexual act. Although not securities-related, X's actions were deceptive, and his misconduct was directed against a person of minority age. X's activities cast doubt on his character and lead us to question his ability to act in a trustworthy and responsible manner in the securities industry. The Commission has consistently recognized that "[a] propensity for dishonest behavior is of particular concern in the securities industry, an industry that presents numerous opportunities for abuses of trust . . . [I]n order to ensure protection of investors, the NASD may demand a high level of integrity from securities professionals." *Kufrovich*, 55 S.E.C. at 627. *See also William J. Haberman*, 53 S.E.C. 1024, 1029 (1998) (holding that to protect investors and maintain investor confidence in the markets, securities professionals are obliged to maintain high ethical standards), *aff'd*, 205 F.3d 1345 (8th Cir. 2000) (Table).

---

[7] *See Frank Kufrovich*, 55 S.E.C. 616, 625 (2002) (upholding FINRA's denial of a statutory disqualification applicant who had committed non-securities related felonies "based upon the totality of the circumstances" and FINRA's explanation of the bases for its conclusion that the applicant would present an unreasonable risk of harm to the market or investors).

We reject the Sponsoring Firm's argument that we should be less concerned about the devious nature of X's felony conviction because the Sponsoring Firm proposes to employ him as a compliance officer, with no access to customers or their funds. X's proposed role at the Sponsoring Firm would place him in a position to make judgments about the Sponsoring Firm's compliance with, and enforcement of, securities rules and regulations—a role that could have a major impact on the Sponsoring Firm's staff, as well as on the investing public and the market. Thus we remain troubled about the questions that X's felony conviction raises about his character and integrity.

Second, X remains subject to community supervision for a lengthy period of time—until January 2017. As X admitted in his testimony, if he fails to comply with the terms of his probation,[8] the court could revoke his probation and order him to serve time in prison. The Commission has expressly shared FINRA's concern in not allowing disqualified individuals serving probation to be associated with member firms. *See, e.g., Kufrovich*, 55 S.E.C. at 627-28 ("We share the NAC's concern that Kufrovich remains on probation."); *Funding Capital Corp.*, 50 S.E.C. 603, 606 (1991) (same); *Michael B. Scheft*, 48 S.E.C. 710, 712 (1987) (same).

Moreover, X has not demonstrated that he has rehabilitated himself during the short period that has elapsed since his felony conviction. X testified that he has not yet begun the one-on-one counseling sessions mandated by the State 1 probation system because he is attempting to transfer his probation from State 1 to State 2,[9] and his probation officer believes that these sessions should occur with the same counselor in one state. Thus X is unable to show that he has successfully complied with or completed a significant condition of his probation.

Accordingly, we conclude that the nature and recency of X's conviction, and the pendency of the probationary period through January 2017, militate against allowing X's re-entry into the securities industry at this time.

C. X's Employment History

Certain aspects of X's employment history give us further reason to question his judgment and character. Although X was forthcoming about his two 180-day jail sentences when he testified before us, we note that he did not reveal this information on any of the Uniform Applications for Securities Industry Registration or Transfer ("Forms U4") that he submitted to the Sponsoring Firm in April, May, or June, 2008. Instead, he replied as follows to question 4 of the Criminal Disclosure Reporting Page on the Forms U4, which asks for "Disposition Disclosure Detail," including "Sentence/Penalty" and "Duration:" "Plead (sic) guilty to a felony, convicted and currently serving 10 years probation with a fine of $1200. 10 year probation began xx/xx/07." Because CRD obtains information from Forms U4, X's CRD therefore fails to mention the two jail sentences imposed for his guilty plea to the two felony counts. The record shows that X did not mislead the Sponsoring Firm or Member Regulation in this regard as the information about his two jail sentences was apparent from the copies of the two 2007

[8] We consider community supervision to be functionally equivalent to probation.

[9] As of the date of this decision, X's application to transfer his probation from Texas to California remains unresolved.

sentencing court orders that the Sponsoring Firm enclosed with its MC-400. Yet we remain troubled by X's failure to fully disclose the outcome of his guilty plea on the Forms U4.

Moreover, X argued at the hearing that he was well qualified for the position as compliance officer with the Sponsoring Firm because he had been a good examiner with NASD from April 2003 until November 2004. In support of his argument, X introduced a copy of his NASD performance evaluation from April 2003 until January 2004 that showed an overall performance rating of "exceeds expectations." In rebuttal, Member Regulation submitted a copy of a memorandum dated June 2004, to X from his former NASD supervisors. This memorandum indicated that NASD placed X on probation for 60 days for several deficiencies, including using "an obscene and derogatory term in reference to [an examined firm] in the presence of firm employees." The memorandum also stated that X's "overly aggressive approach [had] been brought to [his] attention in the past by [his] supervisor, [his] mentor, and at least one other co-worker," and that he had engaged "in inappropriate and unprofessional conduct." We find that these comments are disturbing and do not reflect favorably on X's character and judgment, or his ability to act professionally as the Sponsoring Firm's compliance officer.[10]

D. The Sponsoring Firm and the Proposed Supervision

Finally, although we note the lack of formal disciplinary history for the Sponsoring Firm and the Proposed Supervisor, we remain concerned in several respects. FINRA's 2006 LOC cited the Sponsoring Firm for failing to follow its procedures regarding the review of an individual who was subject to heightened supervision. Specifically, the Sponsoring Firm "did not conduct and/or maintain evidence of conducting an unannounced office exam, and [the individual] did not complete the required additional Continuing Education course." Although the Proposed Supervisor was not named individually in this LOC, he was the Sponsoring Firm's chief compliance officer during the time that this violation occurred. Moreover, when questioned about this LOC during the hearing, the Proposed Supervisor failed to recall the precise reasons for the cited violation and, instead, testified that the Sponsoring Firm had failed to send a formal letter to the representative in question informing him that his heightened supervision had been terminated. While the Proposed Supervisor's inability to recall details of an event that occurred in 2006 may be understandable, we cannot overlook his failure to prepare adequately for the hearing by reviewing the 2006 LOC that was attached as an exhibit to the January 2009 recommendation from Member Regulation to the Proposed Supervisor. We find

[10] At the hearing, Member Regulation raised an additional argument against X's re-entry into the securities industry. Member Regulation asserted that X had violated NASD IM-2420-2 by accepting money from FINRA member firms for acting as an independent contractor compliance consultant while being statutorily disqualified. IM-2420-2 governs the payment of continuing commissions and states that "[u]nder no circumstances shall payment of any kind be made by a member to any person who is not eligible . . . to be associated with a member because of any disqualification . . ."). We do not find it necessary to decide here whether this provision applies in a context that does not involve continuing commissions as the record does not contain sufficient evidence regarding the allegedly violative nature of X's work to support Member Regulation's argument.

that Proposed Supervisor's failure indicates an inattention to detail that does not bode well for the proposed supervisor of a statutorily disqualified individual like X.

The Sponsoring Firm and Proposed Supervisor also demonstrated a reluctance to propose an adequate plan of heightened supervision for X. The MC-400 supplied only a brief sketch of a plan.[11] When Member Regulation attorneys and the Hearing Panel pressed the Proposed Supervisor at the hearing for more details about the proposed plan, the Proposed Supervisor's replies included: "I do plan to review [X's] work. I just don't know what it's going to look like at this time;" "I'm not going to spend a lot of time on [the plan] until I know that, you know, that's going to come to fruition [X's working at the Sponsoring Firm];" "To be quite honest with you, I'm busy enough as it is;" and "I don't plan on giving the detailed, the granular level until [X] is coming on board because I don't know exactly what it's going to look like." Given the Proposed Supervisor's obvious unwillingness to structure a plan of supervision for X, and his emphasis on his busy worklife, we question whether the Proposed Supervisor has sufficient time and dedication to devote to the heightened supervision of a statutorily disqualified individual such as X.

Further, the revised plan of heightened supervision submitted by the Sponsoring Firm in response to a request from the Hearing Panel continues to lack sufficient detail. For example, the revised plan proposes that the Proposed Supervisor will "periodically" review X's electronic communications, branch examinations, internet activity, and written correspondence. The plan does not define how often such review will occur. We find this unacceptable, particularly as X's statutory disqualification involves deceptive conduct that occurred over the internet. The revised plan also proposes that X will be supervised by the Proposed Supervisor when X is in the Sponsoring Firm's home office, but it does not address any plan to supervise X when he is out of the office conducting branch examinations. Finally, the revised plan states that when the Proposed Supervisor is out of the office, Secondary Supervisor will act as X's interim supervisor. Yet CRD shows that Secondary Supervisor is registered only as an investment company/variable products limited representative and principal and is therefore not qualified to supervise X, who is proposed to be registered as a general securities representative, acting in the capacity of a compliance officer.

For these reasons, we conclude that under the proffered supervisory plan, the Sponsoring Firm and the Proposed Supervisor are unable to provide the required heightened level of supervision necessary to assure us that they will effectively prevent and detect possible misconduct on the part of X.

---

[11] *See infra* at note 4.

VII. Conclusion

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 associate with the Sponsoring Firm as a compliance officer/general securities representative. We therefore deny the Application.

On Behalf of the National Adjudicatory Council,

_____

Marcia E. Asquith
Senior Vice President and Corporate Secretary