

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of

X¹

as an

Investment Company Products and
Variable Contracts Limited Representative

with

The Sponsoring Firm

Redacted Decision

Notice Pursuant to
Rule 19h-1
Securities Exchange Act
of 1934

SD10002

Date: 2010

I. Introduction

On June 6, 2008, the Sponsoring Firm filed a Membership Continuance Application (“MC-400” or “the Application”) with FINRA’s Department of Registration and Disclosure. The Application requests that FINRA permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as an investment company products and variable contracts limited representative. In October 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 Proposed Supervisor and the Sponsoring Firm’s chief compliance officer and general counsel, Employee 1. FINRA Employee 1, FINRA Attorney 1, FINRA Attorney 2, and FINRA Employee 2 appeared on behalf of FINRA’s Department of Member Regulation (“Member Regulation”).

For the reasons explained below, we approve 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 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 September 2007, he pled guilty in a federal district court in State 1 to one felony count of “conspiracy to manufacture and distribute and possess with intent to distribute, marijuana.” The court sentenced him to one day of imprisonment with time served, two years of probation, and six months of home confinement. He was also ordered to participate in a substance abuse program. X completed his home confinement and was discharged from probation in September 2009. He also completed an inpatient substance abuse program and continues, to date, to participate in regular meetings of Narcotics Anonymous and personal therapy sessions to deal with his addiction.

The record shows, and X testified at the hearing, that he became involved in growing marijuana to obtain money to support his heroin addiction, which began in 2002. The actual felony criminal activity occurred in 2003, but the investigation and criminal case against him were not finally resolved until 2007. In the meantime, X testified that he stopped using drugs in mid-2004, after he was sentenced to jail in State 1 “for the last of a series of petty theft offenses that [he] committed to fund [his] heroin habit.” Part of that sentence included 90 days in an inpatient “comprehensive substance abuse treatment program,” and X “voluntarily stayed [at the treatment program] an extra three months to bring [his] heroin addiction under control.” Between 2004 and 2007, X substantially aided the United States attorney’s office in its investigation of a drug ring in the City 1, State 1 area. X’s assistance was noted at his felony sentencing hearing in September 2007, when the judge agreed to the prosecution’s motion for a significant downward departure from the federal sentencing guidelines and sentenced X to a two-year probation for the felony marijuana charge.

III. Background Information

A. X

X has not previously been employed in the securities industry. Since June 2006, he has been engaged in back office support for fixed life settlements as an account executive with Company 1, the life insurance affiliate of The Sponsoring Firm. He qualified as an investment company products and variable contracts limited representative in October 2008.

Prior to his association with Company 1, X was employed as a musician and as an assistant music teacher. Since 2004, he has volunteered for an organization known as Company 2 that provides a variety of programs to children with special needs.

[cont’d]

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.

X's criminal history also includes three state misdemeanor convictions for retail fraud (shoplifting) in State 1. He was sentenced in May 2004, to 30 days in jail; in May 2004, to 50 days in jail; and in July 2004, to 40 days in jail. In a written statement and in testimony, X explained that when he was addicted to heroin, he sold all of his possessions (and some of his family members' possessions) to support his habit. When he had sold everything that he could find, he began shoplifting, particularly alcohol, which he then sold to obtain money to buy heroin. X's final shoplifting jail sentence in July 2004 led him to an inpatient substance abuse treatment program and then to a halfway house, where he reconnected with his faith in Judaism, began his community work with Company 2, and became sober.

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

B. The Sponsoring Firm

The Sponsoring Firm is based in City 2, State 1, and it has been a FINRA member since August 2006. The Sponsoring Firm represents that it has one office of supervisory jurisdiction (its home office), no branch offices, 45 registered representatives, and 13 registered principals. The Sponsoring Firm represents that it acts as a back-office operation providing services to insurance companies and broker-dealers that have retail clients that wish to sell their life insurance policies in the life settlements market place. The Sponsoring Firm has no sales or advisory related contacts with the retail clients that own the life insurance policies. Rather, other insurance agencies or broker-dealers have their own agents or registered representatives that have all of the sales and advisory related contacts with their retail clients. In turn, those agencies or broker-dealers use the Sponsoring Firm as their back office for processing life settlement transactions.

The Sponsoring Firm's insurance affiliate, Company 1, provides similar services by acting as a back-office operation for insurance agents. These agents have retail clients that wish to sell their fixed life insurance policies in the life settlements market place. Currently, X works at Company 1 and provides such services to insurance agents—he informs them “about what life settlements are and how they work, makes sure the necessary documentation is properly completed, keeps the agent properly informed during the life settlement transaction, and otherwise assists the agent in connection with the transaction.” X has no contact with the retail client who owns the fixed life insurance policy that is being sold.

The Sponsoring Firm states that if X is approved, he will be able to provide the same services for registered representatives of broker-dealers with retail clients that wish to sell variable life insurance policies. Again, X would have no contact with the retail clients.

FINRA's most recent routine examination of the Sponsoring Firm was conducted in 2009, but the outcome is still pending. FINRA took no action after conducting the Sponsoring Firm's first routine examination in 2007. 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 that it will employ X as an investment company products and variable contracts limited representative. The Sponsoring Firm represents that he will interact "with registered representatives of broker-dealers the firm has service agreements with as a Series 6 registered representative in regards to variable or fixed life settlements." The Sponsoring Firm also proposes that X "will not contact customers of the broker-dealers/registered representatives or the public." The Sponsoring Firm will compensate X by a base salary and bonus.

The Sponsoring Firm proposes that the Proposed Supervisor, a compliance specialist, will be X's primary supervisor. She will be located in the same office as X, and she does not supervise any other individuals. The Proposed Supervisor first registered as a general securities representative in 1983, and qualified as a general securities principal in January 1998. She became associated with the Sponsoring Firm in May 2009. Prior to the Proposed Supervisor's association with the Sponsoring Firm, she was associated with various investment or investment-related firms. FINRA's Central Registration Depository ("CRD®") indicates that she voluntarily terminated her association with each of her prior employers.

The record shows no criminal, disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor. She did, however, file for personal bankruptcy twice, receiving the latest discharge in June 2009, and the prior one in June 1993. The Proposed Supervisor's record indicates that she filed "personal bankruptcy due to birth of grandchild with multiple birth defects . . . [and resulting] medical expenses."

The Sponsoring Firm also proposes that when the Proposed Supervisor is not available, Employee 1 will supervise X. Employee 1 has served as the Sponsoring Firm's chief compliance officer and general counsel since February 2008. Prior to his association with the Sponsoring Firm, Employee 1 was employed as an attorney in law firms. He qualified as a general securities representative in February 2009 and a general securities principal in May 2009. The record shows no criminal, disciplinary or regulatory proceedings, complaints, or arbitrations against Employee 1.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because: 1) X's conviction is recent and serious, and insufficient time has passed for X to prove that he has made significant positive changes to his character; 2) X has three misdemeanor convictions for retail theft that involve dishonest behavior; and 3) the Sponsoring Firm is a new member and "does not have adequate experience in the industry" for Member Regulation to be able "to assess its ability to supervise" a statutorily disqualified individual, particularly because the Sponsoring Firm engages in life settlements, which are a "new area with many regulatory issues that may divert the firm's attention from X." Member Regulation failed to comment specifically on the Sponsoring Firm's proposed plan of heightened supervision for X.

VI. Discussion

A. The Legal 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.³ We assess the totality of the circumstances in reaching a judgment about X's future ability to deal with the public 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. In so doing, we recognize that the sponsoring firm has the burden of demonstrating that the proposed association of the statutorily disqualified individual is in the public interest and does not create an unreasonable risk of harm to the market or investors. *See Continued Ass'n of X*, SD06003, slip op. at 5 (NASD NAC 2006), available at <http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/nacdecisions/p036480.pdf> (redacted decision).

Factors that bear on our assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, whether the person has engaged in any intervening misconduct, and the potential for future regulatory problems. We also consider whether the sponsoring firm has demonstrated that it understands the need for, and has the capability to provide, adequate supervision over the statutorily disqualified person.

After carefully reviewing the entire record in this matter, we find that the Sponsoring Firm has met its burden, and we conclude that X's participation in the securities industry will not present an unreasonable risk of harm to the market or investors. In reaching our conclusion, we considered each of Member Regulation's concerns, which we address below. Accordingly, for the following reasons, we approve the Application for X to associate with the Sponsoring Firm as an investment company products and variable contracts limited representative, subject to the supervisory terms and conditions detailed herein.

B. X's Criminal History and His Evidence of Rehabilitation

As an initial matter, we acknowledge the recency and seriousness of X's 2007 felony criminal conviction. We recognize, however, that a federal district court judge sentenced X to

³ *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); *see also Timothy H. Emerson, Jr.*, Exchange Act Rel. No. 60328, 2009 SEC LEXIS 2417, at *14 (July 17, 2009) (stating that FINRA "appropriately weigh[ed] all the facts and circumstances surrounding [the applicant's] felony conviction and [the firm's] proposed supervisory plan").

two years of probation and six months of home confinement for his crime—both of which X completed by September 2009. The judge also ordered X to undergo substance abuse treatment. X’s written evidence and testimony show that he completed a comprehensive inpatient rehabilitation program, currently attends personal therapy sessions, and continues to be regularly active in Narcotics Anonymous meetings. Thus, X has demonstrated that he has complied with all aspects of the sentence for his September 2007 felony conviction.

Moreover, the record evidence and X’s credible testimony demonstrate to us that his felony marijuana conviction resulted from his desperation to obtain money to feed his heroin addiction, which he overcame in mid-2004. X testified that he participated in growing marijuana in 2003 to raise money to support his drug addiction, and that he also engaged in a series of petty theft/shoplifting offenses in 2003 and 2004 for the same reason. Particularly, he testified that he shoplifted alcohol that he later sold on the streets of City 1. X was sentenced to three separate state jail sentences for retail fraud/shoplifting in 2004—30 days in May 2004; 50 days in May 2004; and 40 days in July 2004. We note that all of these thefts occurred, and that the jail sentences were served, before X’s 2007 felony conviction for growing marijuana. The misdemeanor convictions therefore do not represent intervening misconduct by X, whose criminal activities occurred in 2003 and 2004. By the time of the statutorily disqualifying event—the September 2007 felony conviction—X had been drug-free and had not engaged in criminal activity for more than three years. Currently, X has been drug-free for more than five years.

The record before us shows how hard X has struggled to regain control over his life—and how much he has succeeded. The federal district judge and prosecutor noted this fact during X’s felony sentencing hearing in September 2007. The prosecutor stressed that X had demonstrated an “extraordinary commitment to his success in rehabilitation efforts . . . long before [X] knew that the government was investigating him in [the felony] case, and long before he was indicted in [the felony] case.” The prosecutor also noted X’s volunteer work and his strong support network, including his synagogue and Company 2, in asking the judge to deviate from the federal sentencing guidelines and impose a two-year probation on X. In granting this request, the federal judge also stressed X’s “commitment to productivity and sobriety apart from the pendency of [the felony] case,” and stated that “the criminal history is just an outgrowth of the substance abuse problem that [X] is dealing with.”

Since the September 2007 felony sentencing hearing, more than two years have passed during which X has continued to demonstrate his commitment to his rehabilitation. He has remained drug-free, even under the most emotional circumstances, such as the suicide of one of his triplet brothers in January 2007. He has continued to attend Narcotics Anonymous meetings and personal therapy sessions to deal with his addiction. He continues to maintain close ties with his synagogue, and he volunteers frequently at Company 2. And he has been employed, without incident, by Company 1 since June 2006, providing back-office services to insurance agents that have retail clients who wish to sell their fixed life insurance policies in the life settlements market place. The job description provided for X by the Sponsoring Firm represents that X will not have access to retail clients, but will instead deal exclusively with broker-dealers. We do not share Member Regulation’s concern that X presents a potential threat to the securities industry because he has access to “sensitive customer information.” We find that the Sponsoring Firm

has shown that X is capable of expanding his duties from the insurance industry to provide the same services to broker-dealers in the life settlements market place without representing a risk of harm to the market or investors.

C. The Sponsoring Firm and the Supervisor's Ability to Supervise X

We also find that the Sponsoring Firm and the proposed supervisor are qualified to supervise a statutorily disqualified individual such as X. Member Regulation's first point of contention against the Sponsoring Firm is that it lacks "history in the industry" which makes it "difficult for Member Regulation to assess its ability to adequately supervise a statutorily disqualified individual." We recognize that the Sponsoring Firm is a relatively new firm, having joined FINRA in 2006. But the record shows no disciplinary actions against the Sponsoring Firm.

Secondly, Member Regulation states that it is concerned about the Sponsoring Firm's ability to supervise a statutorily disqualified individual "given [the Sponsoring Firm's] business line (life settlements). Life settlements are a new area with many regulatory issues that may divert the firm's attention from X." We find, however, that the Sponsoring Firm made a strong showing at the hearing regarding its ability to work with life settlements. The Sponsoring Firm emphasized that life settlements are its only business and that it has developed an expertise in the area. Moreover, the Sponsoring Firm represents that it recognizes the potential for difficulties in the business and has developed numerous guidelines to safeguard its activity. For example, the Sponsoring Firm represents that it does not deal in viatical settlements (those relating to terminally ill individuals) at all, only life settlements. In addition, the Sponsoring Firm does not consider any transactions involving individuals who are less than 65 years old, and maintains that it rejects many more settlements than it accepts. The Sponsoring Firm states that it conducts adequate due diligence in each instance to ensure that the parties are protected. Employee 1 testified that the Sponsoring Firm wants its back-office operation to be recognized as the best one for broker-dealers to use when they want to find information on buyers for their retail customers who wish to sell their variable life insurance policies.

Finally, although Member Regulation does not specifically mention the adequacy of the Proposed Supervisor as the primary supervisor, or the Sponsoring Firm's proposed plan of heightened supervision, we also find these acceptable. The Proposed Supervisor will be located on-site with X during all working hours. She is a qualified general securities principal, with no disciplinary history, and X will be the only person that she is responsible for supervising. She testified that she has had experience in supervision and in the life settlement business at other firms, and that she is compensated solely by salary. We also find credible the Proposed Supervisor's testimony that she will be able to supervise X pursuant to heightened supervisory conditions and that she fully understands the responsibility that she is undertaking in doing so. Moreover, we are satisfied that the following heightened supervisory procedures will enable the Sponsoring Firm to reasonably monitor X's activities on a regular basis:⁴

⁴ The items that are denoted by an asterisk are heightened supervisory conditions for X and are not standard operating procedures of the Sponsoring Firm.

1. The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;
2. The Sponsoring Firm, and hence X, will have no retail clients or client accounts;
3. The Sponsoring Firm, and hence X, will have no sales, marketing, or advisory contacts with retail clients;
4. X will not act in a supervisory capacity;
5. *The Proposed Supervisor will supervise X at The Sponsoring Firm's main office in City 2, State 1. X will not be permitted to establish a primary residence office;
6. X will not be permitted to hold seminars involving retail customers;
7. *X will not be allowed to attend conferences where retail customers are present unless he is accompanied by the Proposed Supervisor;
8. *The Proposed Supervisor will review at least 25% of the variable cases in which X is involved, and will maintain a record of such review at the Sponsoring Firm's main office;
9. The Proposed Supervisor, or a designee within the compliance department, will review daily X's incoming and outgoing written correspondence, including emails, faxes, instant messages, and hard copy documents. The Sponsoring Firm does, and will continue to, use a third party service provider for auditing/reviewing emails and instant messages;
10. *For the purposes of communication with agents or registered representatives, X will only be allowed to use an email account that is held at the Sponsoring Firm, with all emails being filtered and monitored through The Sponsoring Firm's email system. The Sponsoring Firm's computer systems and company policy prohibit the use of personal email accounts in the workplace. 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 messages that are either sent or received by X. The Proposed Supervisor will maintain the emails and keep them segregated for ease of review during any statutory disqualification audit. Periodically, the Proposed Supervisor will request an audit of X's personal home computer to ensure compliance with this requirement;
11. *All customer complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor. The Sponsoring Firm's compliance department will prepare a memorandum to the file as to what

measures were taken to investigate the merits of the complaint and the resolution of the matter, and will keep documents pertaining to these complaints segregated for ease of review;

12. *If the Proposed Supervisor is out of the office, Employee 1 will act as X's interim supervisor. A designated member of the compliance department will continue to monitor X's incoming and outgoing mail, which will be preserved for review upon the Proposed Supervisor's return;
13. *For the duration of X's statutory disqualification, the Sponsoring Firm must obtain prior approval (or subsequent approval, if warranted) from Member Regulation if it wishes to change X's responsible supervisor from the Proposed Supervisor to another person, or otherwise alter these supervisory procedures; and
14. *The Proposed Supervisor must certify quarterly (March, June, September, and December) to the Sponsoring Firm's compliance department that she and X are in compliance with all of the above conditions.

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

VII. Conclusion

Accordingly, we approve the Sponsoring Firm's Application to employ X as an investment company products and variable contracts limited representative, subject to the above-mentioned heightened supervisory procedures. In conformity with the provisions of Securities Exchange Act of 1934 Rule 19h-1, the association of X as an investment company products and variable contracts limited representative with the Sponsoring 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,

Marcia E. Asquith
Senior Vice President and Corporate Secretary