BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X[1] as a General Securities Representative with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 SD11001 Date: 2011

I. Introduction

On October 1, 2009, 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 a general securities representative. In September 2010, 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, Attorney 1, and by the Proposed Supervisor. FINRA Employee 1, FINRA Attorney 1, FINRA Attorney 2, and FINRA Attorney 3, 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]

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[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 FINRA 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.

II. The Statutorily Disqualifying Event

X is statutorily disqualified because of a Summary Denial of Agent Registration dated June 2004 (the "State 1 Order"), entered by State 1's Office of Secretary of State. The State 1 Order summarily denied X's registration as a securities agent pursuant to State 1 Statute Section 409.4-412.[3] The basis for the State 1 Order was X's failure to timely report a customer complaint on his Uniform Application for Industry Registration or Transfer ("Form U4"). Specifically, in March 2003, X received a customer complaint that alleged excessive trading, and for which the customer alleged compensatory damages of $90,000 (the "March 2003 Complaint"). X did not amend his Form U4 to report the March 2003 Complaint until January 2004, and thus failed to report the complaint in a timely manner.[4] X's failure to timely report the March 2003 Complaint resulted in inaccurate and incomplete information on his Form U4, and constituted dishonest or unethical practices in the securities business.

X testified that after discovering that the customer had filed the March 2003 Complaint, he requested that the chief compliance officer at his then member firm update his Form U4. Upon transferring to another member firm in January 2004, X discovered that the 2003 Complaint had not been reported on his Form U4. X further testified that he did not learn of the State 1 Order until after its entry.

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[3] X is statutorily disqualified under Art. III, Section 4 of FINRA's By-Laws, which provides that, "[a] person is subject to a 'disqualification' with respect to . . . association with a member, if such person is subject to any 'statutory disqualification' as such term is defined in Section 3(a)(39) of the [Securities Exchange] Act [of 1934 ("Exchange Act")]." In turn, Section 3(a)(39)(F) of the Exchange Act provides that:

> A person is subject to a 'statutory disqualification' with respect to . . . association with a member of, a self-regulatory organization, if such person—(F) has committed or omitted any act or is subject to an order or finding enumerated in subparagraph . . . (H) . . . of paragraph (4) of section 15(b).

"Section 604 of the Sarbanes-Oxley Act expanded the definition of statutory disqualification in Exchange Act Section 3(a)(39) by creating and incorporating Exchange Act Section 15(b)(4)(H) so as to include persons that are subject to any final order of a state securities commission . . . that . . . constitutes a final order based on violations of any laws or regulations that prohibit fraudulent, manipulative or deceptive conduct." *FINRA Regulatory Notice 09-19* (June 2009). The State 1 Order is such an order.

[4] *See* FINRA's By-Laws, Article V, Section 2(c) (requiring that an associated person keep his Form U4 current at all times and amend the form within 30 days after learning of facts or circumstances giving rise to the amendment).

III. Background Information

A. X's Employment and Disciplinary History

X has been employed in the securities industry since 1995. He qualified as a general securities representative (and passed the uniform securities agent state law exam) in May 1995, qualified as a general securities principal in February 1996, and qualified as a limited representative-equity trader in November 2002. X was previously associated with four firms between February 1995 and September 2009.

In February 2001, a customer alleged that X breached his fiduciary duties, engaged in deceptive trade practices, and violated state securities laws relating to unsuitability of margin and options trading. The complaint was forwarded for arbitration and subsequently withdrawn.

In April 2001, a customer alleged that X churned his account, breached his fiduciary duties, and engaged in unauthorized trading. The matter was settled for $14,999, and X did not contribute individually to the settlement.

Finally, the March 2003 Complaint alleged excessive trading in, and unauthorized use of, a customer's margin account. The March 2003 Complaint was settled in arbitration for $19,999. X contributed $9,999 towards the settlement.

The record shows no other criminal, disciplinary or regulatory proceedings, complaints, or arbitrations against X.[5]

[5] At the hearing, a witness for Member Regulation testified generally that in March 2010, FINRA learned of another customer complaint filed against the Sponsoring Firm and X. The Hearing Panel permitted X to supplement the record in connection with this new allegation, and X filed documents after the hearing that indicated that X had no involvement with the customer in question while at the Sponsoring Firm. Based upon this information and the limited information in the record concerning this matter, we have not considered this additional customer complaint in rendering this decision.

B. The Sponsoring Firm

The Sponsoring Firm is based in City 1, State 2, and has been a FINRA member since September 2009, when the principals of the City 1 branch of Firm 1 acquired another broker-dealer and sought to transfer all registered representatives in the City 1 branch (including X) to the Sponsoring Firm.[6] The Sponsoring Firm represented on the Application that it has one office of supervisory jurisdiction ("OSJ"), one branch office, 41 registered representatives, and 9 registered principals. The Sponsoring Firm is engaged in a general securities business, and does not have any disciplinary history.

IV. Procedural History

In March 2010, FINRA filed a Notice Pursuant to Exchange Act Rule 19h-1 (the "March 2010 Notice") pursuant to FINRA Rule 9523(b),[7] in which it approved the Application to employ X as a general securities representative. While the March 2010 Notice was pending with the Commission, and in connection with a routine examination of the Sponsoring Firm conducted in April 2010, FINRA staff notified Member Regulation that they believed X was associating with, and conducting a securities business on behalf of the Sponsoring Firm, notwithstanding his disqualification. Based upon this information, FINRA withdrew the March 2010 Notice in April 2010.

V. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes that it will employ X as a general securities representative in its City 1 office. The Sponsoring Firm represents that X's compensation will be "commissions based with a 70% payout."

X will be supervised by the Proposed Supervisor. The Proposed Supervisor first registered as a general securities representative in January 1996, and qualified as a general securities principal in July 1996. The Proposed Supervisor has been registered with the Sponsoring Firm since September 2009. The Proposed Supervisor serves as the Sponsoring Firm's chief financial officer, chief operating officer, financial and operations principal ("FINOP"), and branch manager for the City 1 office.

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

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6 The Sponsoring Firm's parent company, Firm 2, acquired all of the stock of member firm Firm 3and renamed it Sponsoring Firm in September 2009.

7 FINRA Rule 9523(b) authorizes Member Regulation to, among other things, accept the association of a statutorily disqualified person pursuant to a supervisory plan consented to by the parties with respect to disqualifications arising solely from findings or orders specified in Exchange Act Section 15(b)(4)(H).

In its Application, as amended by the Sponsoring Firm in connection with the March 2010 Notice, the Sponsoring Firm proposed the following heightened supervisory procedures for X (which we quote in their entirety):[8]

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

2) X will not maintain discretionary accounts;

3) X will not act in a supervisory or principal capacity;

4) The Proposed Supervisor will supervise X on-site at the Sponsoring Firm's main office in City 1, State 2;

5) *X must timely file any necessary disclosures to his Form U4, and in so doing, must report the filing of any such amendments or disclosures directly to the Proposed Supervisor. The Proposed Supervisor must maintain records related to such matters and keep them segregated for ease of review during any statutory disqualification audit;

6) The Proposed Supervisor will review and pre-approve each securities account prior to X's opening the account. The Proposed Supervisor will document the account paperwork as approved with a date and signature and maintain the paperwork at the Sponsoring Firm's home office;

7) *The Proposed Supervisor will review and approve X's orders after execution, or as soon as practicable, on a "T + 1" basis. The Proposed Supervisor will then review the trade reports, on a T + 1 basis, evidence his review by initialing the trade reports, and keep copies of the trade reports segregated for ease of review;

8) X will not be permitted to engage in outside sales activities;

9) *The Proposed Supervisor will review X's incoming written correspondence (which would include email communications) immediately upon its arrival and prior to X's receipt and will review and approve outgoing correspondence before they are sent;

10) *For the purposes of client communication, X will only be allowed to use an email account that is held at the Sponsoring Firm, with all emails being filtered through the Sponsoring Firm's email system. 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

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

Firm of all outside email accounts that he maintains. The Proposed Supervisor will conduct a weekly review of all email messages that are either sent to or received by X. The Proposed Supervisor will maintain the emails and keep them segregated for ease of review during any statutory disqualification audit;

11) All complaints pertaining to X, whether verbal or written, will be immediately referred to the Chief Compliance Officer, or his designee. The 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. The CCO will make the Proposed Supervisor aware of any and all complaints filed against X;

12) If the Proposed Supervisor is on vacation or out of the office, Employee 1, will act as X's interim supervisor;[9]

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 status or function at the firm or his responsible supervisor from the Proposed Supervisor to another person; and

14) *The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st of each year) to the Compliance Department of the Sponsoring Firm that he and X are in compliance with all of the above conditions of heighted supervision to be accorded X.

VI. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because: (1) the Sponsoring Firm permitted X to become an associated person of the Sponsoring Firm, and the Sponsoring Firm made payments to X, while he was ineligible to associate with the Sponsoring Firm because of his disqualification; (2) X has demonstrated a propensity towards misconduct by engaging in this intervening misconduct, "which accentuates investor protection concerns when coupled with the misconduct outlined in the customer complaints filed against him;" (3) The Sponsoring Firm and X attempted to deceive FINRA by suggesting X was on "hiatus" while he was in fact associated with the Sponsoring Firm and engaging in the Sponsoring Firm's securities business; (4) the Sponsoring Firm has demonstrated it is incapable of adhering to securities rules and regulations by permitting X to associate with the Sponsoring Firm, and the Sponsoring Firm "is clearly incapable of providing supervision and oversight to any individual who is subject to disqualification; and (5) the Proposed Supervisor is not a suitable supervisor

[9] Employee 1 became registered as a general securities principal in August 2003. In 1999 Employee 1 was convicted of a non-disqualifying misdemeanor. He has been the subject of one customer complaint, from November 2002, which was settled in arbitration for $25,000. Employee 1 did not contribute to the settlement.

because he was presumably aware of, and permitted X to engage in his misconduct, and "it appears that the Proposed Supervisor would not be able to devote the requisite time to supervising X, given his other responsibilities at the Sponsoring Firm."

VII. Discussion

A. The Legal Standard

In evaluating an application like this, we assess whether the sponsoring firm has demonstrated 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*, Redacted Decision No. SD06003, slip op. at 5 (NASD NAC 2006), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/nacdecisions/p036480.pdf; *see also Frank Kufrovich*, 55 S.E.C. 616, 624 (2002) (holding that FINRA "may deny an application by a firm for association with a statutorily-disqualified individual if it determines that employment under the proposed plan would not be consistent with the public interest and the protection of investors"); FINRA By-Laws, Art. III, Sec. 3(d) (providing that FINRA may approve association of statutorily disqualified person if such approval is consistent with the public interest and the protection of investors). 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, the totality of the regulatory and criminal history, 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. The sponsoring firm has the burden of demonstrating that the proposed association is in the public interest despite the disqualification. *See Timothy P. Pedregon, Jr.*, Exchange Act Rel. No. 61791, 2010 SEC LEXIS 1164, at *16 & n.17 (Mar. 26, 2010).

After carefully reviewing the entire record in this matter, we find that X's proposed association with the Sponsoring Firm would create an unreasonable risk of harm to investors and the market based upon X's improper association with the Sponsoring Firm while he was statutorily disqualified and the Sponsoring Firm having permitted X to associate with the Sponsoring Firm while he was disqualified. Accordingly, we deny the Application for X to associate with the Sponsoring Firm as a general securities representative.

B. X Associated with the Sponsoring Firm While Disqualified

FINRA's By-Laws prohibit a statutorily disqualified person from associating with a broker-dealer while disqualified. Article III, Section 3 of the FINRA By-Laws provide that, "[n]o person shall become associated with a member . . . if such person is or becomes subject to a disqualification under Section 4." Article III, Section 4 of FINRA's By-Laws provide that, "[a] person is subject to a 'disqualification' with respect to membership, or association with a member, if such person is subject to any 'statutory disqualification' as such term is defined in Section 3(a)(39) of the [Exchange] Act." In addition, FINRA has stated that "a person who is subject to disqualification may not associate with a FINRA member in **any capacity** unless and until approved in an Eligibility Proceeding." *See* Statutory Disqualification Process, *available at* www.finra.org/Industry/Enforcement/Adjudication/NAC/StatutoryDisqualificationProcess.[10]

FINRA's By-Laws define a "person associated with a member" or "associated person of a member" as "a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration" with FINRA. *See* FINRA By-Laws, Article I(rr).[11] Similarly, the Exchange Act defines an associated person to include any employee of a broker or dealer, although it exempts from having to register any person associated with a broker or dealer who performs only clerical or ministerial functions. *See* Exchange Act Section 3(a)(18); *see also* NASD Rules 1060(a)(1) and (a)(2) (providing that persons associated with a member whose functions are solely and exclusively clerical or ministerial, or who are not actively engaged in the investment banking or securities business, are not required to be registered with FINRA). Thus, the definition of associated person includes not only those persons who conduct activities or functions requiring registration under FINRA's rules, but also certain unregistered employees as set forth in Article I(rr) of FINRA's By-Laws.[12] FINRA has construed the interpretation of an associated person broadly. *See Dist. Bus. Conduct Comm. v. Paramount Invs. Int'l, Inc.*, Complaint No. C3A940048, 1995 NASD Discip. LEXIS 248, at *12 (NASD NBCC Oct. 20, 1995).

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[10] *Cf.* FINRA Rule 8311 (providing that if a person is suspended from association with a member, the member must not allow such person to remain associated with it in any capacity, including a clerical or ministerial capacity, and may not receive any remuneration from a member that results directly or indirectly from a securities transaction).

[11] "'Investment banking or securities business' means the business, carried on by a broker . . . of purchasing and selling securities upon the order and for the account of others[.]" *See* FINRA By-Laws, Article I(u).

[12] FINRA's procedural rules governing eligibility proceedings expressly provide procedures governing statutorily disqualified persons whose functions are purely clerical or ministerial in nature. *See* FINRA Rule 9522(e)(2)(E) (authorizing Member Regulation to approve the association of a statutorily disqualified person after the filing of an MC-400 if the disqualified person's functions are purely clerical or ministerial in nature).

1. X's Activities

Member Regulation asserts that from September 2009 until at least mid-April 2010,[13] X improperly associated with the Sponsoring Firm while statutorily disqualified based upon the following: (1) during an April 2010 examination, FINRA staff observed X on the telephone discussing a stock with an apparent customer, and had several stock quotes on his computer screen; (2) X made sales or received commissions of $31,300 in November 2009; (3) in October 2009, X sent from his Firm email account an email to the Sponsoring Firm's chief compliance officer ("CCO"), directing her to register several representatives; (4) X received a number of loans from the Sponsoring Firm and a $40,000 payment from Firm 2; and (5) from September 2009 through April 2010, X made approximately 1,300 calls from his work phone at the Sponsoring Firm. X and the Sponsoring Firm argue that X did not improperly associate with the Sponsoring Firm while he was statutorily disqualified, and even if he did improperly associate with the Sponsoring Firm, such misconduct was unintentional, did not result in any independent violations of FINRA or SEC rules, and should not serve as a basis for denial of the Application.

We address X's activities as alleged by Member Regulation and discussed at the hearing, below.[14]

a. X's Communications with Customers

At the hearing, X testified that the Sponsoring Firm, upon learning that he was statutorily disqualified, transferred his customers to Employee 1.[15] X further testified that while he was statutorily disqualified and pending approval of the Application, he wanted to preserve his relationship with his customers. X stated that he "wanted to reach out [to his customers] and say hey how are you . . . I'm still not registered yet, we're working on it. But, you know if you have any concerns or you need any investment advice I will transfer you to Employee 1." X admitted that during this time period he routinely talked with his customers. X's exhibits show that at least 322 of the 1,288 calls (25 percent) X made from his office telephone from September 2009

[13] The Sponsoring Firm filed a Form U4 on X's behalf for him to associate with the Sponsoring Firm in September 2009. In September 2009, Member Regulation provided the Sponsoring Firm with notice that X was statutorily disqualified pursuant to FINRA Rule 9522(a)(1), and informed the Sponsoring Firm that, "[g]enerally, no person who is subject to a statutory disqualification can associate with a FINRA member unless the member requests and receives written approval from FINRA."

[14] The evidence presented by Member Regulation did not support its allegations that X discussed stock transactions with a customer in April 2010, and that X made sales of securities or received commissions from securities transactions in November 2009.

[15] Approximately 34 of X's customer accounts transferred from Firm 1 to the Sponsoring Firm. After Employee 1 assumed responsibility over X's transferred accounts, he received a 10% commission on these accounts, whereas Employee 1 received a 70% commission on his other customers' accounts.

through April 2010 were calls to his existing customers.[16] While the majority of these 322 calls lasted for less than two minutes, 71 of the calls lasted for two minutes or longer.

Similarly, Employee 1 testified that he wanted to aid X so that neither he nor the Sponsoring Firm would lose the customers' business. Employee 1 stated that he would sometimes ask X to call a customer to speak with the customer initially, and then X would transfer the customer to Employee 1 so that Employee 1 could engage in a securities transaction on behalf of the customer. Employee 1 testified that the goal was not to "scare the clients being that we had just transferred from one firm to the other and have a new voice to the phone."

b. X Was in the Office Every Day During Business Hours

X testified that after the Sponsoring Firm filed the Application, and until FINRA staff raised concerns regarding his presence in the Sponsoring Firm's offices sometime after the routine examination conducted in April 2010, he came into the office every day during normal business hours. X stated that he kept normal business hours at the Sponsoring Firm because he wanted to continue his routine. Other than speaking with customers, X testified that he made personal phone calls, monitored the markets, and socialized with his colleagues. A FINRA examination manager testified that the CCO informed him that X was in the Sponsoring Firm's offices for "office synergy." The Proposed Supervisor testified that he believed that the SEC and FINRA preferred for a statutorily disqualified individual to be in the office pending approval of his application so that he could be properly supervised.[17] The Proposed Supervisor stated that unless X was regularly in the office, "there would be no other way for me to evidence that I'm supervising him if he was at home."

c. Undisclosed Loans to X

In December 2009, the Sponsoring Firm and the Sponsoring Firm's president, chief executive officer, and owner ("CEO"), made a loan to X in the amount of $10,000. The loan was evidenced by a promissory note dated December 2009, and was payable upon demand and

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[16] The 1,288 phone calls solely consist of calls X made from his office telephone, and do not include any phone calls X received at his office during this time period. X's communications with his customers are at odds with a statement he made to FINRA in October 2009 that, "[c]urrently, I am on a hiatus since being notified that I am statutorily disqualified by FINRA."

[17] The Proposed Supervisor's understanding is based upon a sentence contained on FINRA's website in a section entitled, "The Important Role of Supervision." The pertinent sentence states that, "as a general matter, FINRA and the SEC prefer that disqualified individuals seeking to act as registered representatives in retail sales capacities be supervised on-site by a qualified and experienced general securities principal[.]" This language, however, refers to a proposed supervisory plan of a sponsoring firm and the preference that a statutorily disqualified individual be supervised on-site (versus remotely) once the application is approved and the eligibility proceeding is complete.

forgivable after one year. The Sponsoring Firm and the CEO made eight additional loans to X beginning in January 2010 through and including August 2010. Each loan was evidenced by a note similar to the December 2009 promissory note, and X received $90,000 total in connection with these monthly loans. Although the terms of the notes provided that each loan was forgivable after one year from the date of the loan, the CEO testified that the parties intended that the loans would be forgivable only if X became registered with the Sponsoring Firm and worked for the Sponsoring Firm for a year. The CEO further testified that the Sponsoring Firm would seek repayment from X if FINRA denied the Application.

In addition, pursuant to a promissory note dated November 2009, Firm 2 made a $40,000 forgivable loan to X (the "Firm 2 Loan"). The parties agreed to the terms of the Firm 2 Loan in June or July 2009, and Firm 2 made a $40,000 payment to X pursuant to the Firm 2 Loan in November 2009. The Firm 2 Loan was intended as a signing bonus for X joining the Sponsoring Firm, and the balance owed by X was to be reduced by five percent for every month X remained registered as an associated person with the Sponsoring Firm. In total, X received $130,000 from the Sponsoring Firm, the CEO, and Firm 2, including $30,000 from Firm 2 and the CEO after Member Regulation recommended denial of the Application based, in part, upon X's receipt of payments from the Sponsoring Firm.

FINRA staff only learned of the loans after the April 2010 examination, and the Sponsoring Firm did not inform FINRA about the loans from the Sponsoring Firm and the CEO or Firm 2. Indeed, in response to a question on the MC-400 asking, "[d]oes the Applicant, or any officer, partner, direct or indirect owner of the Applicant, have or contemplate loans to the prospective employee, either directly or indirectly[,]" the Sponsoring Firm responded "no." The Proposed Supervisor and the CCO each testified that they believed that the Application would be promptly approved, and at the time the Sponsoring Firm filed the Application in October 2009, no loans had been made to X and the parties did not contemplate any future loans to X. At the time the Sponsoring Firm filed the Application, however, Firm 2 had agreed to make the Firm 2 Loan to X, and the Sponsoring Firm never updated its response to reflect the monthly loans from the Sponsoring Firm and CEO beginning in December 2009 or payment on the loan from Firm 2 in November 2009. In addition, the CEO never disclosed the loans to Member Regulation during numerous telephone conversations; instead he informed Member Regulation that X was "destitute" and that prompt approval of the Application was necessary so that X could earn a salary for his living expenses.

d. Email from X and Listing in Sponsoring Firm Directory

In an email from X to the CCO dated October 2009, X asked the CCO to register several registered representatives in certain states. The email was from X's Sponsoring Firm account, and identified X as "Senior Vice President of Investments." The CCO testified that she registered the representatives as requested in the email, and X testified that he did not and could not email any customers during this time period. The Sponsoring Firm also listed X as "Senior Vice President of Investments" on its internal phone directory.

2. X Associated With The Sponsoring Firm While Statutorily Disqualified

We find that X engaged in several activities that demonstrate that he improperly associated with the Sponsoring Firm while statutorily disqualified. X, as a statutorily disqualified person, could not associate with the Sponsoring Firm in any capacity. X, however, regularly communicated with his customers in an effort to maintain their accounts at the Sponsoring Firm and to preserve his relationships with the customers. Although X testified that during the 322 conversations he initiated with his customers, he did not directly discuss securities, purchase or sell securities on behalf of his customers, and did not provide them with investment advice, X admittedly facilitated activity in the customers' accounts. X regularly asked his customers whether they needed investment advice, and X had repeated conversations with a number of his customers. If X's customers responded affirmatively to X's inquiries, X would transfer the customers to Employee 1 to effectuate securities transactions. Employee 1 testified that he would sometimes ask X to get a customer on the phone so Employee 1 could effectuate a securities transaction on the customer's behalf. At a minimum, X engaged in clerical or ministerial functions in connection with the Sponsoring Firm's securities business. *See Stephen M. Carter*, 49 S.E.C. 988, 989 (1988) (holding that the duties of a clerical employee of a broker-dealer, even where they did not include selling securities to customers, were part of the conduct of its securities business); *Dist. Bus. Conduct Comm. v. Cannatella*, Complaint No. C8A920075, 1994 NASD Discip. LEXIS 227, at *55 (NASD NBCC Oct. 12, 1994) (same).

X also kept normal and regular business hours at the Sponsoring Firm while he was statutorily disqualified, maintained a desk at the Sponsoring Firm, and had a Sponsoring Firm telephone extension and email account. *See SEC v. Telsey*, 1991 U.S. Dist. LEXIS 21780 (S.D.N.Y. 1991) (finding that former registered representative improperly associated with member firms because, among other things, he had a phone and office at the firms and was in the firms' offices daily during business hours); *The Ass'n of X as a Gen. Secs. Representative,* Redacted Decision No. SD01018, at 6 (NASD NAC 2001), *available at* http://www.finra.org/Industry/Enforcement/Adjudication/NAC/StatutoryDisqualificationDecisions/2001/P012617 (disapproving of statutorily disqualified individual's five or six visits with his son or office manager at member firm). These facts indicate that X was an employee of the Sponsoring Firm and thus an associated person of the Sponsoring Firm, notwithstanding his statutory disqualification and the pending Application. Indeed, the Proposed Supervisor testified that he supervised X during this period.

The numerous and regular monthly loans from the Sponsoring Firm and CEO further evidence the Sponsoring Firm's control over X while he was statutorily disqualified. X received regular monthly payments in the form of forgivable loans from the Sponsoring Firm and the CEO, and the express terms of the notes evidencing the loans provided that they were forgivable one year from the date each loan was made. These regular monthly payments to X while he was statutorily disqualified (which, as discussed below, the Sponsoring Firm failed to disclose) circumvented FINRA's policy prohibiting payments to statutorily disqualified individuals. *See* IM 2420-2 (providing 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[.]"). X also received an additional $40,000 from Firm 2 while he was statutorily disqualified as a signing bonus for purportedly joining the Sponsoring Firm.

X and the Sponsoring Firm argue that X's activities did not render him an associated person of the Sponsoring Firm because X never provided investment advice to customers and never engaged in securities transactions on behalf of customers. X and the Sponsoring Firm thus appear to argue that X's activities while statutorily disqualified did not violate FINRA rules because X did not engage in any activity requiring registration.

We disagree. A statutorily disqualified individual may not associate with a member firm in any capacity, even one that does not require the individual to be registered under FINRA's rules.[18] *See* FINRA By-Laws, Article III, Sec. 3 ("[n]o person shall become associated with a member . . . if such person is or becomes subject to a disqualification"); Article I(rr) (defining associated person to include "a natural person engaged in the investment banking or securities business who is directly or indirectly controlling or controlled by a member, whether or not any such person is registered or exempt from registration"); *see also Dep't of Enforcement v. Walker*, Complaint No. C10970141, 2000 NASD Discip. LEXIS 2, at *18 (NASD NAC Apr. 20, 2000) ("As a statutorily disqualified person, Walker was prohibited from associating with Lexington until both he and the Sponsoring Firm had received the proper regulatory approvals."). Member Regulation's September 2009 notice to the Sponsoring Firm stated that, "[g]enerally, no person who is subject to a statutory disqualification can associate with a FINRA member unless the member requests and receives written approval from FINRA." FINRA's website, which the Sponsoring Firm's principals purportedly referenced to determine that X could engage in any activities with the Sponsoring Firm not requiring registration under FINRA's rules, also makes it clear that a statutorily disqualified individual may not associate with a member firm in any capacity unless and until approved in an eligibility proceeding. X's and the Sponsoring Firm's belief that X could associate with the Sponsoring Firm pending approval of the Application so long as he did not engage in any activities requiring registration under FINRA's rules is erroneous, and at odds with FINRA's By-Laws, rules and correspondence from Member Regulation. Moreover, it contravenes the very purposes of FINRA's rules governing the association of a statutorily disqualified individual with a member firm.

X and the Sponsoring Firm also argue that even if X associated with the Sponsoring Firm while he was statutorily disqualified, such misconduct was unintentional, resulted from the Sponsoring Firm's inexperience with the statutory disqualification process, and did not result in any independent violations of FINRA's rules. The Sponsoring Firm further argues that it never hid X's presence in the office from FINRA or the SEC.[19] Intent, however, is unnecessary for a

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[18] We note that individuals who solicit customers on behalf of their member firms must be registered under NASD Rule 1031. *See Dep't of Enforcement v. Flannigan*, Complaint No. C8A980097, 2001 NASD Discip. LEXIS 36, at *13 (NASD NAC June 4, 2001) (citing *NASD Notice to Members 88-50* (July 1988)), *aff'd*, 56 S.E.C. 8, 17-18 (2003). Because X associated with the Sponsoring Firm despite his statutory disqualification, we need not determine whether he solicited customers, and thus acted in a capacity requiring registration.

[19] For example, the Proposed Supervisor testified that he introduced X to SEC staff that were present in the Sponsoring Firm's offices during a February 2010 examination, and even

[Footnote continued on next page]

finding that a statutorily disqualified individual improperly associated with a member firm. *See Paramount*, 1995 NASD Discip. LEXIS 248, at *24 (stating that "respondents' failure to assure that WF not be associated with the firm in any capacity represents a breach of an important regulatory requirement, for which a claim of 'mere negligence' is wholly unavailing as a defense"); *see also Cannatella*, 1994 NASD Discip. LEXIS 227, at *37-38 (rejecting argument that a statutorily disqualified person's association with a member firm did not violate FINRA's rules because he did not intend to avoid his disqualification). Moreover, ignorance of FINRA's rules does not excuse misconduct. *See Dep't of Enforcement v. Harvest Capital LLC*, Complaint No. 2005001305701, 2008 FINRA Discip. LEXIS 45, at *43-44 (FINRA NAC Oct. 6, 2008). And, under the circumstances, the misconduct at issue is X having improperly associated with the Sponsoring Firm while statutorily disqualified. It is unclear from the record whether X or the Sponsoring Firm violated additional FINRA or SEC rules or regulations in connection with X's activities while statutorily disqualified. Regardless, whether X complied with all other securities rules and regulations while improperly associating with the Sponsoring Firm has no bearing on our decision.

We also reject the Sponsoring Firm's claim that it generally relied upon the advice of counsel in determining that X could talk to customers, remain in the Sponsoring Firm's offices, and receive payments from the Sponsoring Firm without violating FINRA's rules. Reliance on the advice of counsel does not excuse X's improper association with the Sponsoring Firm. *See Howard Brett Berger*, Exchange Act Rel. No. 58950, 2008 SEC LEXIS 3141, at *39 (Nov. 14, 2008) (holding that an advice of counsel claim is irrelevant to liability in a case where scienter is not an element). Further, the Sponsoring Firm has not shown that it reasonably relied upon the advice of counsel in permitting X to associate with the Sponsoring Firm. "[T]o successfully assert reliance on the advice of counsel, a respondent must establish that the respondent made full disclosure to counsel, appropriately sought to obtain relevant legal advice, obtained it, and then reasonably relied on the advice." *See Leslie A. Arouh*, Exchange Act Rel. No. 62898, 2010 SEC LEXIS 2977, at *52 (Sep. 13, 2010) (internal quotations omitted). Other than several general statements from the Sponsoring Firm's principals that they reached out to counsel after learning of X's statutory disqualification and being informed that the Sponsoring Firm could loan funds to X, the Sponsoring Firm has not specified exactly what it disclosed to counsel or the exact advice of counsel. It is also unclear how any advice that X could associate with the Sponsoring Firm while statutorily disqualified pending approval of the Application could have been reasonably relied upon by the Sponsoring Firm in light of the clear prohibition against associating in any capacity—whether requiring registration under FINRA's rules or not—with a member firm while statutorily disqualified.

X and the Sponsoring Firm also suggest that X was permitted to associate with the

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[cont'd]

informed them that he was statutorily disqualified. The SEC examination, however, began more than four months after X first began to associate with the Sponsoring Firm notwithstanding his statutory disqualification.

Sponsoring Firm while the Application was pending because the Sponsoring Firm checked the box on the MC-400 indicating that he was "[c]urrently associated with the Sponsoring Firm and registered with FINRA." X and the Sponsoring Firm also assert that FINRA accepted payment of the fee to process the Application (and thus implicitly accepted the Sponsoring Firm's characterization of X's status), and FINRA never subsequently informed the Sponsoring Firm that X could not associate with the Sponsoring Firm in any capacity while the Application was pending.[20] X and the Sponsoring Firm also point to a February 2010 letter from Member Regulation stating that the Sponsoring Firm needed to agree to a heightened supervisory plan for the "continued association" of X with the Sponsoring Firm.

X and the Sponsoring Firm, however, incorrectly characterized X's status on the MC-400 and he could not associate with the Sponsoring Firm while the Application was pending. Regardless, the Sponsoring Firm's characterization of X's status does not control our determination of whether X improperly associated with the Sponsoring Firm. Similarly, it is well-established that the actions or representations of FINRA staff do not bind FINRA. *See JJFN Servs., Inc.*, 53 S.E.C. 335, 342 (1997) (holding that statements made by Nasdaq staff with respect to an application for listing on the automatic quotation system did not bind NASD).[21] Moreover, X and the Sponsoring Firm cannot shift blame to FINRA for X's improper association with the Sponsoring Firm while statutorily disqualified. *See Donner Corp. Int'l*, Exchange Act Rel. No. 55313, 2007 SEC LEXIS 334, at *64 (Feb. 20, 2007) (holding that "a broker-dealer cannot shift its responsibility for compliance with applicable requirements to the NASD"); *see also Dep't of Enforcement v. Am. First Assoc. Corp.*, Complaint No. E1020040926-01, 2008 FINRA Discip. LEXIS 27, at *17 (FINRA NAC Aug. 15, 2008) (holding that respondent could not shift responsibility to FINRA even if he sought FINRA's advice and did not receive a response); *Cannatella*, 1994 NASD Discip. LEXIS 227, at *55 ("We do not believe, however, that even if the Association failed to detect Cannatella's disqualification at that time, Cannatella's improper association with [a member firm] should be excused.").

X improperly associated with the Sponsoring Firm for approximately seven months while the Application was pending. X's association with the Sponsoring Firm while disqualified was a serious violation of FINRA's rules. *See Paramount*, 1995 NASD Discip. LEXIS 248, at *25 ("We believe that . . . the association of the statutorily disqualified person with a member firm is one of the most serious regulatory violations"). Consequently, we find that the proposed association of X with the Sponsoring Firm would not be in the public interest and would create

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[20] Likewise, the Proposed Supervisor testified that he believed because X was associated with the Sponsoring Firm when the Sponsoring Firm submitted X's Form U4, he could continue to associate with the Sponsoring Firm as long as he did not offer investment advice to customers. As set forth herein, the Proposed Supervisor's belief was mistaken and contrary to the language in FINRA's By-Laws and guidance on its website.

[21] At the time of Member Regulation's February 2010 letter, X had already been improperly associating with the Sponsoring Firm despite his statutory disqualification for almost five months.

an unreasonable risk of harm to the market and investors, as X's misconduct demonstrates the potential for future regulatory problems.

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

We also find that the Sponsoring Firm has failed to demonstrate that it could effectively supervise a statutorily disqualified individual such as X. The Sponsoring Firm permitted X to associate with the Sponsoring Firm notwithstanding his statutory disqualification. While we note the lack of disciplinary history for the Proposed Supervisor, the Proposed Supervisor knew, but was not concerned, that X was talking to customers and came into the office every day. The Proposed Supervisor also knew that X was receiving monthly loans from the Sponsoring Firm beginning in December 2009 and that X received $40,000 from Firm 2. The Proposed Supervisor testified that he had never supervised a statutorily disqualified individual before, had never seen an MC-400, and had never been through an eligibility proceeding.

Although the Proposed Supervisor and the CC testified that they consulted with others and referred to FINRA's website for guidance in connection with the activities X could engage in and in completing the Application, FINRA's website states that a statutorily disqualified person "may not associate with a FINRA member in **any capacity** unless and until approved in an Eligibility Proceeding." In addition, FINRA's By-Laws expressly provide that a statutorily disqualified individual may not associate with a member firm, and define an associated person to include unregistered individuals or individuals exempt from registration. The Proposed Supervisor and the other principals at the Sponsoring Firm, however, mistakenly believed that X could engage in any activities at the Sponsoring Firm that did not require registration as a registered representative (such as providing investment advice and purchasing and selling securities on behalf of customers). We question the Sponsoring Firm's ability to effectively supervise a statutorily disqualified individual if its principals do not understand FINRA's fundamental rules. Our concerns are amplified by the fact that the Proposed Supervisor, X's primary supervisor under the proposed heightened plan of supervision, currently supervises 42 registered representatives at the Sponsoring Firm, and serves as the branch manager of the City 1 office, the Sponsoring Firm's chief financial officer, chief operating officer, and FINOP. We conclude that the Proposed Supervisor has insufficient time to devote to the heightened supervision of a statutorily disqualified individual such as X.

We are also troubled by the Sponsoring Firm's failure to disclose the $130,000 in forgivable loans to X from the Sponsoring Firm, the CEO, and Firm 2. The Sponsoring Firm failed to disclose the loan from Firm 2 when it filed the Application, and failed to update the Application in either November or December 2009 when X began receiving funds under the loans from Firm 2 and the Sponsoring Firm. Further, the Sponsoring Firm did not inform Member Regulation about the loans, and FINRA staff only discovered the loans after the April 2010 routine examination. Indeed, the CEO told Member Regulation staff that X was "destitute" and had no source of income, notwithstanding the payments to X pursuant to the loans. These

omissions and misrepresentations demonstrate the Sponsoring Firm's inability to enforce and effectively supervise X under any plan of heightened supervision.[22]

For these reasons, we conclude that the Sponsoring Firm and Proposed Supervisor are unable to assure us that they will effectively prevent and detect possible misconduct on the part of X.

VIII. 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 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

[22] We are also troubled by one element of the Sponsoring Firm's plan of heightened supervision, developed with input from Member Regulation and submitted in connection with the March 2010 Notice. Specifically, the Sponsoring Firm proposes that Employee 1 will serve as X's backup supervisor in the event that the Proposed Supervisor is out of the office. The testimony at hearing, however, indicated that Employee 1 would receive an override on X's business. Were we otherwise inclined to approve this Application, which we are not, we would have given the Sponsoring Firm an opportunity to submit a revised plan that cures this deficiency. As we have explained, however, X improperly associated with the Sponsoring Firm while statutorily disqualified and while the Application was pending, and the Sponsoring Firm permitted X to improperly associate with it. These facts alone warrant denial of this Application.