

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF	:	
MARKET REGULATION,	:	
	:	
	:	
Complainant,	:	Disciplinary Proceeding
	:	No. CMS030006
v.	:	
	:	Hearing Officer - AWH
CASTLE SECURITIES CORP.	:	
(CRD #16077)	:	Hearing Panel Decision
Freeport, NY	:	
	:	December 3, 2003
	:	
	:	
Respondent.	:	

Member firm (1) failed to submit required information to the Order Audit Trail System (“OATS”), in violation of NASD Marketplace Rule 6955(a) and Conduct Rule 2110; (2) failed to establish supervisory procedures designed reasonably to achieve compliance with OATS requirements, in violation of NASD Conduct Rules 2110 and 3010; and (3) failed to comply with the Automated Confirmation Transaction Service (“ACT”) requirements, in violation of NASD Marketplace Rule 6130(b) and Conduct Rule 2110. Respondent fined a total of \$80,000, and, for the supervisory violation, suspended for ten business days or until it submits to the Department of Market Regulation for review and approval, and implements changes in its supervisory policies and procedures reasonably designed to detect and prevent OATS and ACT violations, whichever occurs later. Respondent also assessed costs.

Appearances:

Timothy B. Nagy, Esq., and Michael R. Levy, Esq.
for the Department of Market Regulation

Michael T. Studer, President
for Castle Securities Corp.

DECISION

Introduction

On January 24, 2003, the Department of Market Regulation (“Department”) issued a three-cause Complaint in this matter against Castle Securities Corp. (“Castle” or “Respondent”), alleging that Castle (1) failed to submit required information to OATS, in violation of NASD Marketplace Rule 6955(a) and Conduct Rule 2110; (2) failed to establish supervisory procedures designed reasonably to achieve compliance with OATS requirements, in violation of NASD Conduct Rules 2110 and 3010; and (3) repeatedly failed to comply with ACT requirements, in violation of NASD Marketplace Rule 6130(b) and Conduct Rule 2110. Respondent filed an Answer to the Complaint on February 12, 2003, and requested a hearing. The Department filed a Motion for Summary Disposition on April 28, 2003, which was denied without prejudice on May 20, 2003. On June 11, 2003, a hearing was held in New York, New York, before a Hearing Panel composed of the Hearing Officer, a former member of the Market Regulation Committee, and a current member of the District 10 Committee. The Hearing Panel granted the Department’s Motion for Summary Disposition at the end of the hearing. Both parties filed post-hearing submissions, as directed.

Findings of Fact¹

Respondent

Castle, whose principal office is located in Freeport, New York, has been a member of NASD since November 1985.² Its NASD membership was in full force and

¹ References to Department’s exhibits are designated as CX_; Respondents’ exhibits, as RX_; and the transcript of the hearing, as Tr._.

² Stipulations at ¶ 1.

effect at the time of the hearing.³ Castle is one of several subsidiaries of Castle Holding Corporation (“Castle Holding”).⁴ The principals and officers of Castle Holding operate or have operated a variety of other businesses through its subsidiaries, including, among others, Citadel Securities, Castle Trucking Corporation, and GalaxyNet, Inc.⁵

Order Audit Trail System

In 1996, the Securities and Exchange Commission (“SEC”) ordered NASD to create an order audit trail device, designed to achieve effective market surveillance and rule enforcement.⁶ The SEC deemed such a system to be crucial to maintaining the integrity of the Nasdaq market.⁷ Pursuant to this directive, NASD developed OATS and, on March 6, 1998, the SEC approved Rules 6950 through 6957⁸ (the “OATS Rules”). Throughout the process, NASD issued several Notices to Members that explained the system in greater detail and provided compliance dates.⁹ The implementation of OATS occurred in three stages: (1) in Phase 1, all market makers and Electronic Communication Networks were required to report electronic orders for Nasdaq securities (including SmallCapSM and Nasdaq National Market® securities and convertible bonds); (2) in Phase 2, all member firms had to report electronic orders for Nasdaq securities; and

³ *Id.*

⁴ The Department suggested that Castle Holding has 16 subsidiaries, but did not elicit testimony to confirm this assertion. Tr. at 140.

⁵ Tr. at 138-40.

⁶ *In re National Association of Securities Dealers, Inc.*, Exch. Act Rel. No. 37,538, 1996 SEC LEXIS 2146, at **11-12 (Aug. 8, 1996).

⁷ *Order Approving . . . New Rules 6950 Through 6957 Relating to the Creation of an Order Audit Trail System*, Exch. Act Rel. No. 39,729, 1998 SEC LEXIS 395, at *8 (Mar. 6, 1998) (“A comprehensive audit trail, beginning with the time an order is placed and continuing to record the life of the order through the process of execution, is essential to maintaining the integrity of the Nasdaq market.”).

⁸ *See id.*

⁹ *See, e.g.*, NASD Notice to Members 99-27, 1999 NASD LEXIS 97, (Apr. 20, 1999); NASD Notice to Members 98-73, 1998 NASD LEXIS 88, (Sept. 1998).

(3) by Phase 3, all member firms were required to report manual orders for Nasdaq securities.¹⁰

Several Notices to Members contained internet links to registration forms and provided guidance about the implementation of OATS.¹¹ The registration form itself also contains a Registration Activity Checklist to help registrants ensure that they complete all steps required to begin reporting to OATS.¹² In order to allow time for familiarization and testing, NASD recommended that organizations reporting to OATS complete registration approximately 120 days before they were actually required to report.¹³ In addition, to help member firms become acclimated to the program, NASD provided phone numbers and Staff contact information.¹⁴

Castle registered with OATS to participate in Phase 2 and submitted the appropriate OATS Subscriber Initiation and Registration Form.¹⁵ Castle received notice through the OATS Internet Website that its scheduled reporting date was September 15, 1999.¹⁶ Nonetheless, Castle did not submit the required order information to OATS for the first 191 consecutive business days after its scheduled reporting date.¹⁷ Castle eventually submitted that information on June 19, 2000, after the Staff of the OATS

¹⁰ NASD Notice to Members 99-27, 1999 NASD LEXIS 97, at *1 (Apr. 20, 1999); NASD Notice to Members 98-73, 1998 NASD LEXIS 88, at *1 (Sept. 1998).

¹¹ *See, e.g.*, NASD Notice to Members 99-27, 1999 NASD LEXIS 97, at ** 2-3, (Apr. 20, 1999); NASD Notice to Members 98-73, 1998 NASD LEXIS 88, at **3-10 (Sept. 1998).

¹² NASD Notice to Members 99-27, 1999 NASD LEXIS 97, at *5 (Apr. 20, 1999).

¹³ *See id.* at **4-5.

¹⁴ *See id.* at *3; NASD Notice to Members 73-98, 1998 NASD LEXIS 88, at **2-3, 10 (Sept. 1998).

¹⁵ CX 1; Tr. at 35-36.

¹⁶ CX 2; Tr. at 34-35. Although Phase 2 participants were supposed to report electronic orders starting August 1, 1999, each phase of the program was implemented according to a staggered schedule. Castle was actually required to comply by September 15, 1999. CX 44 at ¶ 4.

¹⁷ CX 44, at ¶¶ 5, 8; CX 4, CX 5.

Compliance Section sent the firm a letter, dated June 7, 2000, advising the firm that its account was delinquent.¹⁸

On June 21, 2000, Michael T. Studer (“Studer”), Castle’s President, submitted a response letter to the OATS Compliance Section Staff, in which he reported that Castle had a verbal agreement with another subsidiary of Castle Holding, Galaxynet, Inc., to handle its OATS transmissions, and believed that all of the required data through June 20, 2000 had been transmitted.¹⁹

The firm again failed to meet its OATS reporting requirements during the period October 19, 2000, through December 7, 2000.²⁰ Castle’s OATS password expired on October 18, 2000, and, accordingly, all of its data submissions were rejected for the next 35 consecutive business days.²¹ Castle resumed proper OATS reporting on December 8, 2000, after the OATS Compliance Section again contacted Studer to advise him of the firm’s delinquency.²² Castle had not detected the problem through its own monitoring system.

Supervisory Procedures

On July 31, 1998, the SEC approved amendments to NASD Marketplace Rules 6954 and 6957 and Conduct Rule 3110,²³ which expanded the recording and recordkeeping requirements associated with the OATS Rules. Members were then notified about the changes and advised of compliance dates.²⁴ NASD Notice to Members

¹⁸ Tr. at 38, 45-46; CX 44 at ¶ 9; CX 5.

¹⁹ CX 7.

²⁰ CX 19; Tr. at 49-50.

²¹ CX 44 at ¶ 13; CX 20; Tr. at 60.

²² CX 44 at ¶ 13; Stipulations at ¶ 9.

²³ *Order Approving Proposed Rule Change Relating to NASD's Order Audit Trail System and Recordkeeping Rules*, Exch. Act Rel. No. 40,286, 1998 SEC LEXIS 1605 (July 31, 1998).

²⁴ NASD Notice to Members 98-73, 1998 NASD LEXIS 88, at **2-3 (Sept. 1998).

98-96²⁵ lists four criteria that should be included in a firm's written supervisory procedures: (1) identify the individual responsible for the review of OATS reporting, including, but not limited to, the repair of rejections; (2) describe specifically what type of review(s) is to be conducted; (3) specify how often the review is to be conducted; and (4) describe how the review is to be evidenced. These criteria were reiterated in the December 4, 2000 edition of The Oats Report.²⁶

Castle's written supervisory procedures did not comport with these criteria. Studer was listed as the OATS supervisor and the person responsible for OATS reporting.²⁷ However, there was no procedure for review, and no specified frequency of review, of OATS information by the OATS supervisor (other than clock synchronization), and no procedure for monitoring the OATS website by the OATS supervisor.²⁸

The OATS Report also reminded members that "[t]hese procedures should incorporate frequent reviews by the firm of data reported on the OATS Web interface." However, no one at Castle was reviewing the website for compliance, including Studer, who, despite being Castle's designated compliance person, did not, and still does not, know how to use the website.²⁹ Castle's own compliance and supervisory system did not detect its OATS reporting deficiencies either during the 191 business day period, starting September 15, 1999, or the 35 business day period, starting October 19, 2000.

²⁵ NASD Notice to Members 98-96, 1998 NASD LEXIS 121, at **8-9 (Dec. 1998); CX 36.

²⁶ Available at http://www.nasdr.com/oats_0012_procedures.asp. See also Tr. at 61-62.

²⁷ CX 14 at 8; Tr. at 62.

²⁸ Tr. at 63.

²⁹ Tr. at 178.

Automated Confirmation Transaction Service

ACT is an automated system owned and operated by The Nasdaq Stock Market, Inc. that compares trade information entered by ACT participants and submits “locked-in” trades for clearance and settlement.³⁰ In this system, both parties to a trade submit transaction data to the ACT system, and both have the opportunity to review the other side’s version of the trade. Once both parties have reviewed a trade report and accepted the trade, it is a “locked-in trade.” However, if a party declines the trade, the report is purged from the ACT system at the end of trade date processing.³¹ If no action is taken either to accept or decline the trade, the system automatically will lock-in the trade on the following business day.³² ACT participation is mandatory and is explained in detail in NASD Marketplace Rules 6120-6190. Notice to Members 98-82 also discusses the implementation of this system.³³

NASD Marketplace Rule 6130(b) specified the time and manner of submitting trade reports to ACT: “ACT Participants shall transmit trade reports to the system for transactions in Nasdaq securities within 90 seconds after execution, or shall utilize the Browse function in ACT to accept or decline trades within twenty (20) minutes after execution” Castle failed timely to accept or decline trades in ACT for 1,399 transactions, representing 83% of the firm’s transactions, between October 1, 2001, and December 31, 2001.³⁴

³⁰ NASD Marketplace Rule 6110(d).

³¹ NASD Marketplace Rule 6140.

³² *Id.*

³³ 1998 NASD LEXIS 99 (Oct. 1998).

³⁴ Tr. at 89; CX 24 at 4; CX 27.

Discussion

Granting of Complainant's Motion for Summary Disposition

At the conclusion of the hearing, the Hearing Panel granted the Department's Motion for Summary Disposition, which had been previously denied without prejudice. In granting this motion, the Hearing Panel determined that, when the evidence was viewed in a light most favorable to Respondent, there was no genuine dispute of material fact. The Department, therefore, was entitled to summary disposition as a matter of law.³⁵ The rationale for the Hearing Panel's ruling follows.

Failure to Submit Required Information to OATS

Failure to report order information by the specified OATS implementation date is a violation of NASD Rules 6955 and 3110.³⁶ In addition, the "[f]ailure of a member or person associated with a member to comply with any of the requirements of Rule 6951 through Rule 6957 may be considered conduct that is inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110."³⁷

Castle did not report order information until 191 business days after the implementation date, in clear contravention of the requirements of Rules 6955 and 3110. Castle claims it should be exonerated because it was unfamiliar with OATS, and because it delegated its responsibilities to a reporting agent, Galaxynet, Inc.³⁸ However, a respondent may not shift responsibility to a third party for compliance with rules and

³⁵ NASD Procedural Rule 9264(e); *S.E.C. v. Hughes Capital Corp.*, 124 F.3d 449, 452 (3d Cir. 1997) (describing the standard for summary judgment under § 56(c) of the Federal Rules of Civil Procedure, which is identical to the standard for Rule 9264(e)). *See also Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986) ("only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment.").

³⁶ NASD Notice to Members 99-27, 1999 NASD LEXIS 97 at **1-2, 4 (Apr. 20, 1999); NASD Notice to Members 98-73, 1998 NASD LEXIS 88, at **2, 6 (Sept. 1998).

³⁷ NASD Marketplace Rule 6956.

³⁸ Answer at ¶¶ 3, 5.

regulations, and ignorance of publicly available information is not a defense to liability for compliance failure.

Numerous Notices to Members regarding the implementation of OATS provided contact information, suggested utilizing a practice period, and allowed ample time to resolve questions and address concerns *before* a firm was scheduled to begin reporting. There is simply no valid justification for Castle's claim of OATS ignorance.

NASD Marketplace Rule 6955 provides that "[e]ach Reporting Member remains primarily responsible for compliance with the requirements of this rule, notwithstanding the existence of [a written] agreement [to delegate reporting obligations]."³⁹ Castle represented to the Staff that it had a *verbal* agreement with Galaxynet, Inc. to assist in OATS transmissions.⁴⁰ However, Castle has not produced evidence of any written agreement with Galaxynet, Inc., as was required by Rule 6955(c)(1).

After four months of proper reporting, Castle again lapsed into OATS noncompliance for a period of 35 business days because it allowed its password to expire. Studer blamed these subsequent violations on the departure of certain personnel from Castle and the failure of new employees to understand how to use the passwords.⁴¹ However, such a change in personnel does not excuse Castle's noncompliance. The OATS Website provided members with notice of the expiration of a password and the resultant rejection of reports.⁴² The OATS Subscriber Manual also warned that the

³⁹ NASD Marketplace Rules 6955(a) and (c)(3). *See also* NASD Notice to Members 98-33, 1998 NASD LEXIS 44, at *4 (Mar. 1998) (emphasizing that it is the firm's ultimate responsibility to ensure compliance with OATS requirements); CX 37, at p. 2. OATS Frequently Asked Questions—Compliance, at <http://www.nasdr.com/3320.asp> (Feb. 16, 1999)

⁴⁰ CX 7.

⁴¹ Tr. at 165-66.

⁴² Tr. at 52-57; CX 39 at 22.

password would routinely expire.⁴³ Moreover, member firms are notified, generally within one hour of transmission, whether submissions are accepted or rejected.⁴⁴

Member firms receive ample warnings and explanations regarding OATS reporting. If Castle had been properly monitoring its submissions and compliance requirements, it easily could have prevented the expiration of its password and the subsequent rejection of its transmissions. Therefore, the Hearing Panel finds that Castle's failures to file OATS data during these two time periods constitute violations of NASD Marketplace Rule 6955 and Conduct Rule 2110.

Failure to Establish and Maintain a Supervisory System that Ensured OATS Compliance

NASD Conduct Rule 3010(b) states that “[e]ach member shall establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of this Association.” Accordingly, a firm's written supervisory procedures are deemed adequate if they are “reasonably designed” to achieve such compliance.

Upon review of Castle's supervisory procedures, the OATS Compliance Section Staff concluded that the firm failed to satisfy the supervisory guidelines communicated to it via Notices to Members and The OATS Report.⁴⁵ The Hearing Panel agrees that Castle's written supervisory procedures are deficient and do not comport with applicable NASD requirements. Those procedures provide no (1) information or direction on the method, manner, or frequency of OATS information review by the OATS Supervisor; (2)

⁴³ Tr. at 55-56

⁴⁴ Tr. at 53-54.

⁴⁵ CX 44 at ¶¶ 17, 18.

designation of the person responsible for interfacing with the OATS website; and (3) review of the accuracy and timeliness of trade reporting conducted by third parties on behalf of the firm.⁴⁶ Studer himself recognized that clearer written supervisory procedures would have been beneficial to the new employee who handled Castle's OATS reporting.⁴⁷ Castle's written supervisory procedures proved ineffective both to prevent and detect the firm's failure to submit the necessary OATS data on two separate, lengthy occasions. Those compliance failures could have been discovered and quickly remedied by the firm's routine monitoring of its reporting statistics via the OATS Website.

Studer cannot avoid responsibility for deficient supervision by ascribing responsibility for noncompliance with reporting requirements to a departing staff member and an inexperienced replacement for that staff member. The president of a member firm "is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient."⁴⁸ As President and the head of compliance for Castle, Studer is required to handle compliance issues properly, despite any normal staff attrition. Moreover, as the named OATS supervisor, he had the direct responsibility in the firm for OATS compliance. He did not delegate his compliance responsibilities to any other person, nor could he have properly delegated any responsibility to an inexperienced replacement staff member. Had the firm implemented proper supervisory procedures, and had Studer properly exercised his supervisory responsibilities, the repeated compliance deficiencies would have been detected and prevented. The Hearing Panel, therefore, concludes that the firm's

⁴⁶ CX 14.

⁴⁷ Tr. at 166.

⁴⁸ *In re William H. Gerhauser, Sr.*, 1998 SEC LEXIS 2402, at **17-18 (Nov. 4, 1998).

supervisory system and its written supervisory procedures were not reasonably designed to achieve compliance with the OATS Rules.

Failure to Accept or Decline Trades in ACT in a Timely Manner

Marketplace Rule 6180 states: “Failure of an ACT Participant or person associated with an ACT Participant to comply with any of the rules or requirements of ACT may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110.”

Castle’s explanation for not complying with ACT requirements is that it reasonably delegated responsibilities to a third party, its clearing broker.⁴⁹ However, that assertion is contrary to the statement of Castle’s outside counsel that Castle’s clearing broker refused to provide acceptance services for the firm.⁵⁰ Nonetheless, as stated earlier, the firm is ultimately responsible for ensuring compliance with NASD rules and for monitoring its activities.

Castle points out that it did eventually accept transactions in ACT, although it did so beyond the 20-minute requirement. However, that claim does nothing to affect Castle’s liability for noncompliance with ACT requirements. The employee who was assigned to accept or decline trades in ACT “was an [Castle] Online support guy” who had never been in the trading room or on the trading desk, and who “was not coming in always at 9:00 every day.”⁵¹ Moreover, Castle did not take seriously its obligation to comply with the time requirements of Rule 6130. In a letter, dated March 14, 2002,

⁴⁹ Answer at ¶ 5.

⁵⁰ CX 28. *See also* Tr. at 120-21 (Castle Online supervisor acknowledging that NDBC was not performing ACT acceptance services and that the situation “dragged on for an extended period of time.”)

⁵¹ Tr. at 171-72. *See also* Tr. at 175 (“I don’t think he knew the significance of 20 minutes versus an hour.”). Castle Online had software that allowed customers remote access to the Nasdaq market. Tr. at 114.

Castle's outside counsel asserted, without explanation, that Rule 6130 was "not artfully drawn," and that Castle's interpretation of the Rule was that "it did not have to accept or decline a trade within the 20 minute time frame as set forth in 6130(b)."⁵² However, those bald assertions contradict the plain language of the Rule, and, in any event, do not mitigate the violations. Outside counsel also claimed that the 20-minute timeframe for accepting or declining trades is unduly burdensome, particularly in light of the system's automatic acceptance that would take place on the next trading day.⁵³ However, to rely on automatic next day acceptance, particularly, as here, over an extended period of time, is to abandon the firm's control over the size of its overnight open positions and to place its capital at undue risk. Moreover, any lengthy uncertainty over whether a trade has been accepted constitutes a risk to the contra-party of duplicate execution or cancellation of the order. Until that trade is accepted, the contra-party retains the ability to decline the trade, even where the reporting side may believe that the transaction was valid. Finally, adherence by all firms to the time requirements of ACT is necessary for the efficiency of the Nasdaq market in clearing and processing trades. Tr. 102-03.

Sanctions

OATS Reporting Violations

The NASD Sanction Guidelines suggest a fine of \$5,000 to \$10,000 for an initial violation of OATS reporting requirements.⁵⁴ Egregious cases warrant fines in the range of \$15,000 to \$150,000.⁵⁵ There are a number of "Principal Considerations" in the

⁵² CX 28.

⁵³ *Id.*; Answer at ¶ 7.

⁵⁴ NASD SANCTION GUIDELINES, p. 67 (2001).

⁵⁵ *Id.*

Sanction Guidelines that apply to this case and that demonstrate that this is an egregious case that calls for significant sanctions.⁵⁶

First, Castle neither accepted responsibility for its compliance problems, nor acknowledged its misconduct prior to detection and intervention by a regulator. On two occasions, NASD Staff had to contact Castle to warn it about reporting deficiencies. The firm had been unaware of its failure to report for 191 consecutive business days, and again, for 35 consecutive business days. The firm still does not accept responsibility for its actions, and continued to blame its reporting agent.⁵⁷

Second, Castle failed to employ any corrective measures to avoid a recurrence of its repeated and extensive misconduct, even after NASD staff brought that misconduct to Castle's attention.⁵⁸ Furthermore, Castle has yet to monitor properly its OATS compliance. No one at Castle is reviewing the OATS Website to ensure that the appropriate data is transmitted, Studer admits that he does not know how to do so, and there are no reasonable supervisory procedures to ensure that someone reviews the Website.⁵⁹

Finally, Castle's failure to report OATS data undermined the regulatory audit trail.⁶⁰ Missing OATS data is not subject to any regulatory surveillance or sweeps by NASD staff, is not subject to analysis of patterns through the Advanced Detection System, and undermines complete and accurate surveillance of the market.⁶¹

⁵⁶ *Id.* at 9-10.

⁵⁷ *Id.*, at 9, Principal Consideration No. 2.

⁵⁸ *Id.*, at 9-10, Principal Consideration Nos. 3, 8, 9, and 15.

⁵⁹ Tr. at 177-78.

⁶⁰ NASD SANCTION GUIDELINES, p. 66 (2001).

⁶¹ Tr. at 63-64.

Castle suggests, as a mitigating factor, that had NASD staff conducted its review of Castle's OATS reporting sooner, its period of noncompliance would have been shorter.⁶² However, even if that were true; a respondent "cannot shift responsibility to the NASD for complying with relevant rules and regulations." *Dist. Bus. Conduct Comm. v. Freedom Investors Corp.*, No. C8A950011 (NBCC Jan. 27, 1997).

The Department requests that Castle be censured and fined a minimum of \$25,000. The Hearing Panel agrees that a fine of \$25,000 for Castle's egregious OATS violations is appropriate to remediate the misconduct.

Supervisory Deficiencies

The Sanction Guidelines recommend a fine of \$5,000 to \$50,000 for deficient supervisory procedures, and a suspension of the firm for up to two years.⁶³ A bar may be appropriate in cases involving systemic supervision failures.⁶⁴ The Guidelines further provide that it is NASD's policy to impose "progressively escalating sanctions on recidivists."⁶⁵ Castle's history of supervisory deficiencies is therefore relevant for sanctioning purposes in this case.⁶⁶

In 1996, the National Business Conduct Committee fined Castle and Studer \$25,000 for deficient supervisory procedures, as well as for engaging in manipulation and charging excessive and fraudulent markups. Additionally, Studer was suspended for 30 days in all capacities and required to requalify as a general securities principal.⁶⁷ Castle was again sanctioned in March 2003 for supervisory deficiencies, as well as for violations

⁶² Respondent's Opposition to Complainant's Motion for Summary Disposition at ¶ 2(a).

⁶³ NASD SANCTION GUIDELINES, p. 108 (2001).

⁶⁴ *Id.*

⁶⁵ *Id.* at 3.

⁶⁶ *Id.* at 9, Principal Consideration No. 1.

⁶⁷ *Market Surveillance Comm. v. Castle Securities Corp.*, 1996 NASD Discip. LEXIS 37 (NBCC Oct. 21, 1996), *aff'd*, 1998 SEC LEXIS 24 (SEC Jan. 7, 1998).

of the anti-fraud provisions of the federal securities laws and NASD rules. Castle was separately fined \$88,300 for the fraud violations; Castle and Studer were jointly fined \$37,500 for inadequate supervision, and Studer was suspended in all capacities for 90 days, and, for a second time, he was ordered to re-qualify as a general securities principal. *DOE v. Castle Securities Corp.*, C3A010036 (Mar. 28, 2003), *appeal docketed*, (NAC Apr. 21, 2003). The Hearing Panel finds Castle's disciplinary history to be a significant aggravating factor for sanctioning purposes.

The Guidelines provide three additional factors to consider in cases involving supervisory deficiencies: (1) whether respondent ignored "red flag" warnings; (2) the "[n]ature, extent, size, and character of the underlying misconduct"; and (3) the "[q]uality and degree of [the] implementation of the firm's supervisory procedures and controls."⁶⁸

The numerous Notices to Members concerning the design and implementation requirements of OATS should have been a red flag to Castle, warning it to ensure that it had in place procedures to provide the requisite supervisory scrutiny of its trade reporting. Moreover, the staff's initial notification to Castle of its deficient procedures, and its ongoing investigation of the initial violations should have placed Castle on heightened awareness of those deficiencies, and prompted the firm to take immediate remedial action. Castle not only failed to do so, but it again lapsed into noncompliance for an additional 35 consecutive business days. Studer's testimony demonstrates that the firm still does not fully appreciate the significance of its supervisory compliance with either OATS or ACT reporting. To date, it appears that no one at the firm is reviewing

⁶⁸ NASD SANCTION GUIDELINES, p. 108 (2001).

OATS reporting performance via the OATS Website, and it has not updated its supervisory system to ensure OATS compliance.⁶⁹

For the supervisory violations, the Department recommends that Castle be fined a minimum of \$40,000 and suspended for at least ten business days. The Hearing Panel agrees that the imposition of a \$40,000 fine is necessary to remediate the misconduct. However, the Hearing Panel believes that Castle should be suspended for ten business days, or until such time as it submits to the Department for review and approval, and thereafter implements, changes in its supervisory policies and procedures reasonably designed to detect and prevent OATS and ACT violations, which ever occurs later.

ACT Violations

The Guidelines suggest a fine of \$1,000 to \$2,000 for the first ACT trade reporting violation, and expulsion or suspension of the firm in egregious cases.⁷⁰ The Department argues that the violations are egregious and call for sanctions much higher than those suggested for a more routine case.

Castle's failure to comply with ACT's guidelines undermined the system's goals and benefits.⁷¹ The delinquent reporting of 1,399 transactions during a three-month period, as well as during a subsequent six-month period, demonstrates a pattern of misconduct over an extended period of time. As with its OATS violations, the firm did not accept responsibility for, or acknowledge, its misconduct prior to detection by

⁶⁹ Tr. at 177-78.

⁷⁰ NASD SANCTION GUIDELINES, p. 72 (2001).

⁷¹ See, e.g., NASD Notice to Members 89-76, 1989 NASD LEXIS 91, at *4 (Dec. 1989) ("HOW ACT HELPS NASD MEMBERS . . . (1) Same-day comparison and locked-in clearing for all NASDAQ trades; (2) Less exposure to price movements for open items; (3) On-line access to the status of each trade report; (4) Faster, more efficient trade reconciliation and confirmation; (5) Increased efficiency of back-office operations.'). See also tr. 102-03.

NASD.⁷² In fact, the firm still denies responsibility for the reporting problems, and, instead, places blame on a third party. After NASD advised Castle of its reporting deficiencies, the firm failed to take remedial measures.⁷³ At the time of the violations, Castle did not have reasonable supervisory procedures to detect or prevent the violations. The responsibility for accepting or declining trades in Act was “delegated to the wrong person,” an individual who did not know the significance of 20 minutes versus an hour.⁷⁴ As noted before, it has yet to develop reasonable supervisory procedures to detect or prevent similar violations.

For the firm’s repeated violations and disregard for its responsibilities, the Department requests a fine of \$15,000 and suggests suspending Castle’s trading activities until the firm demonstrates that the reporting problems have been rectified.⁷⁵ The Hearing Panel will impose the requested fine. The Panel believes that the concerns underlying Enforcement’s suspension request are fully and appropriately addressed by the suspension the Panel is imposing for the supervisory violations. Castle will also be assessed costs of \$1,502.22, consisting of a \$750 administrative fee and a \$752.22 transcript fee.

Respondent’s Inability to Pay Monetary Sanctions

Castle claims that it is unable to pay any monetary sanctions imposed by the Hearing Panel,⁷⁶ and that fines would impact its required net capital.⁷⁷ While the Hearing Panel will take into consideration Castle’s ability to pay the fines imposed, the Panel

⁷² NASD SANCTION GUIDELINES, p. 9, Principal Consideration No. 2 (2001).

⁷³ *Id.* at 9, Principal Consideration Nos. 3 and 5.

⁷⁴ Tr. 174-75.

⁷⁵ Complainant’s Post-Hearing Submission Regarding Sanctions at 13.

⁷⁶ Respondent’s Post-Hearing Brief at 2.

⁷⁷ Tr. at 14-15.

notes that, to protect investors and insure market integrity, sanctions must be commensurate with a respondent's violative conduct. *See Dist. Bus. Conduct Comm. v. Escalator Securities, Inc.*, 1998 NASD Discip LEXIS 21, at *12 (NBCC Feb. 19, 1998) (“... [A] fine that otherwise appropriately sanctions a firm's violative conduct . . . may not be limited by claims that the payment will cause the firm to be in noncompliance with its net capital requirement, or to close its doors. Because of the overriding public interest, member firms should be appropriately sanctioned based on their violative conduct, and not merely on the projected effect of the monetary sanction on the firm's balance sheet.”); NASD SANCTION GUIDELINES, p. 8 (2001) (“Although Adjudicators must consider a respondent's bona fide inability to pay when the issue is raised by a respondent, monetary sanctions imposed on member firms need not be related to or limited by the firm's required minimum net capital.”).

In an attempt to satisfy its burden of proving an inability to pay, Castle offered balance sheets⁷⁸ and a pro forma tax return⁷⁹ as exhibits at the hearing. These unaudited, unsigned, and un-notarized records, however, do not constitute reliable evidence of Castle's true financial condition.⁸⁰ In any event, these documents do not demonstrate that Castle is unable to pay the monetary sanctions imposed.⁸¹ Castle's balance sheet shows total assets of \$59,442.13, including more than \$45,000 on deposit with two clearing

⁷⁸ RX 8.

⁷⁹ CX 41.

⁸⁰ *DOE v. Richard Steven Levitov*, 2000 NASD Discip. LEXIS 12, at **33-34 (NAC June 28, 2000) (finding that sanctions would not be reduced because the respondents submitted unsigned, un-notarized documentation of their purported inability to pay).

⁸¹ In its Post-Hearing Brief, Castle further urges the Hearing Panel to consider that its financial condition has further deteriorated since the hearing, and it has ceased to do business. However, Castle supports this assertion with information that is not part of the evidentiary record and, therefore, cannot be used to evaluate Respondent's ability to pay monetary sanctions. *See* Focus Report, attached to Respondent's Post-Hearing Brief (providing unaudited financial information, prepared by Studer that indicates that, as of June 30, 2003, Castle “had no cash and \$17,046 net capital” and that “for the three months ended June 30, 2003, [it] had \$30,352 total revenues and a \$12,879 net loss.”).

firms, and \$71,957.80 in receivables that Castle has elected to write off as unlikely to be collected.⁸²

In its post-hearing submission, Castle notes that the NASD Sanction Guidelines state, “[a]djudicators should consider firm size with a view toward ensuring that the sanctions imposed are not punitive.”⁸³ However, the Department counters that,⁸⁴ among the factors the Panel is to consider in assessing “firm size” are “other entities that the firm controls, *is controlled by, or is under common control with.*”⁸⁵ Castle is controlled by Castle Holding, and Castle’s principals are also owners, officers, and directors of Castle Holding. Castle Holding has a history of providing Castle with capital, as needed.⁸⁶ In fact, Castle Holding’s Form 10-QSB filing for the period ended June 30, 2002, reported a \$50,000 reserve for SEC and NASD matters pending against Castle Securities, Corp.⁸⁷

On brief, Castle claims, without supporting documentation, that, although Castle Holding has attempted to bolster Castle’s financial position in the past, Castle Holding presently has \$760 in cash assets, negative stockholders’ equity, and an outstanding \$150,000 U.S. Small Business Administration loan.⁸⁸ That claim comes too late to be tested by cross-examination or other documentary evidence. Because it is undocumented, the Hearing Panel can give it no weight. Moreover, the evidence that was admitted at the hearing shows a Castle Holding balance sheet with \$426,108.38 in total

⁸² RX 8 at 3.

⁸³ NASD SANCTION GUIDELINES, p. 3, (2001); Complainant’s Post-Hearing Submission Regarding Sanctions at 2.

⁸⁴ Complainant’s Post-Hearing Submission Regarding Sanctions at 19.

⁸⁵ Sanction Guidelines at 3, fn. 1 (2001) (emphasis added). *See also DOE v. Michael F. Flannigan, Protective Group Securities Corp.*, 2001 NASD Discip. LEXIS 36, at *24 (NAC June 4, 2001) (finding that respondent had not successfully demonstrated a current inability to pay monetary sanctions because of its ability to obtain additional capital).

⁸⁶ Tr. at 128-29.

⁸⁷ CX 42 at 8.

⁸⁸ Respondent’s Post-Hearing Brief at 2.

current assets, including \$106,656.43 in cash, and \$79,417.35 in other assets as of September 30, 2002.⁸⁹ Accordingly, Castle has failed to provide reliable and probative evidence in support of its alleged inability to pay fines that the Hearing Panel concludes are appropriate in light of the firm's repeated and extensive noncompliance with NASD rules.⁹⁰

Conclusion

Castle Securities Corp. is (1) fined \$25,000 for failing to properly submit OATS data, in violation of NASD Marketplace Rule 6955(a) and Conduct Rule 2110; (2) fined \$40,000, and suspended for a period of ten business days, or until such time as it submits to the Department for review and approval, and thereafter implements, changes in its supervisory policies and procedures reasonably designed to detect and prevent OATS and ACT violations, whichever occurs later, for failing to establish supervisory procedures reasonably designed to achieve OATS and ACT compliance, in violation of NASD Conduct Rules 3010 and 2110; and (3) fined \$15,000 for failing to comply with ACT requirements, in violation of NASD Marketplace Rule 6130(b) and Conduct Rule 2110. Castle will also be assessed costs of \$1,502.22, consisting of a \$750 administrative fee and a \$752.22 transcript fee.

⁸⁹ CX 43 at 1-2.

⁹⁰ Respondent raised two additional matters in its post-hearing brief which are addressed below, but will not affect the Hearing Panel's decision on sanctions: (1) At hearing and on brief, Castle argued that one of its witnesses declined to testify at the hearing because of alleged intimidation tactics by the Department. Tr. at 18, Respondent's Post-Hearing Brief at 2. As the Hearing Officer stated at the hearing, there may have been a misunderstanding among staff members of the Department, Studer and the potential witness. Tr. at 19-20. However, the specific allegations fall far short of constituting intimidation, and there has been no showing that the witness' testimony would affect the ultimate outcome. (2) In Castle's Post-Hearing Brief, Studer claims that he was unable to obtain a transcript of the hearing. Respondent's Post-Hearing Brief at 3. There is no allegation of interference by a third party, and it appears that the availability of the transcript is merely a matter of contract between Castle and the reporting service. In any event, Castle has made no showing that it has been prejudiced by its lack of a copy of the transcript.

The sanctions shall become effective on a date determined by NASD, but not sooner than 30 days from the date this Decision becomes the final disciplinary action of NASD, except that, if this Decision becomes the final disciplinary action of NASD, the suspension shall become effective with the opening of business on February 2, 2004.

SO ORDERED.

Alan W. Heifetz
Hearing Officer
For the Hearing Panel

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