NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. CHRIS DINH HARTLEY (CRD#1799834) San Jose, CA, Respondent.	:	Disciplinary Proceeding No. C01010009 **HEARING PANEL DECISION** Hearing Officer - SW Dated: November 5, 2002

For violating NASD Conduct Rules 3040 and 2110 by participating in the offer and sale of promissory notes to five customers without prior written notice to, and approval of, his employer, the Hearing Panel suspended Respondent for 30 calendar days and fined him $7,500. The Hearing Panel also ordered Respondent to pay the $2,059.86 costs of the Hearing.

Appearances

David A. Watson, Esq., Regional Attorney, Los Angeles, California, for the Department of Enforcement.

Chris Dinh Hartley, pro se.

DECISION

I. Procedural Background

On October 2, 2001, NASD Department of Enforcement ("Enforcement") filed its one-count Complaint, alleging that Respondent, while associated with Pruco Securities Corporation ("Pruco"), between September 1996 and January 1997, offered and sold securities in the form of promissory notes issued by First Lenders Indemnity Corporation ("FLIC"), without providing prior notice to Pruco, in violation of Conduct Rules 3040 and 2110.

Respondent admitted that he participated in the sale of the FLIC promissory notes, without providing prior notice to, or obtaining prior approval from, Pruco. However, Respondent argued that the FLIC promissory note was not a security, but was commercial paper. Respondent also argued that (i) he reasonably believed that the FLIC promissory notes were not securities when he sold them, (ii) he did not attempt to hide his involvement with FLIC from Pruco, mentioning the FLIC notes to his Pruco supervisor, and (iii) he submitted written information to Pruco concerning FLIC at his annual compliance review, consistent with Pruco's procedures.

The Hearing Panel conducted a Hearing in San Francisco, California on June 14, 2002.[1] In addition to the testimony of Respondent, Enforcement offered the testimony of a Pruco employee, Julie Mohanco, and two former Pruco employees, Marlene Kasparian and Susan Korp. Respondent testified on his own behalf and offered the testimony of Randy _____, an insurance broker and former FLIC agent.

The Hearing Panel admitted: (i) 26 exhibits, offered by Enforcement, labeled CX-1 through CX-26, and (ii) six exhibits offered by Respondent, labeled RX-1 through RX-6.

II. Findings of Fact and Conclusions of Law

A. Jurisdiction

Respondent became employed by Pruco on November 16, 1987.[2] (CX-1, p. 3). On April 14, 1988, he was registered as an investment company and variable products

[1] "Tr." refers to the transcript of the Hearing held on June 14, 2002; "CX" refers to Complainant's exhibits; and "RX" refers to Respondent's exhibits.

[2] Until May 1996, Respondent was dually employed and registered with The Prudential Insurance Company of America. (CX-1, p. 2).

representative with Pruco. (Id.). On March 24, 1998, he became registered as a general securities representative with Pruco. (Id.). Since January 6, 2000, Respondent has been registered as general securities representative with Morgan Stanley DW, Inc. (CX-1, p. 2). Accordingly, the Hearing Panel determines that NASD has jurisdiction over Respondent.

B. Chronology of Respondent's Participation with FLIC

In April 1988, Respondent became registered as an investment company and variable products representative for Pruco. (CX-1, p. 3). In 1996, Respondent, working out of Pruco's San Jose office, primarily sold life insurance and annuities for Pruco and other insurance entities. [3] (Tr. p. 167). Respondent and the other non-captive insurance agents advised Pruco of their other commercial relationships at the annual compliance meeting, which generally took place at the end of the year. (Tr. p. 15). Pruco provided its agents with a compliance manual, which included a prohibition on private securities transactions on page 2 thereof, but, in describing securities on page 2, Pruco only listed stocks, bonds, options, and tax shelters.[4] (CX-12, p. 3).

FLIC, a California corporation, was formed in April 1995 to "underwrite, purchase, service and resell retail automobile installment loan contracts . . . in the commercial market."[5] (CX-22, p. 1). FLIC issued promissory notes to finance its

[3] In 1996, Respondent earned only $2,000 in mutual fund commissions. (Tr. p. 167).

[4] On August 9, 1996, Respondent executed Pruco's registered representative statement, which when prohibiting selling away referenced only page 2 of Pruco Securities Compliance Overview 1996-1997. (CX-13, pp. 3-4). The registered representative statement contained no reference to a more expansive definition of the term "security." (Id.).

[5] FLIC, in a January 5, 1994 "No Action Request" letter to the Securities Division of the California Department of Corporations, represented that First Boston Acceptance Corporation, a Nevada corporation, was doing business in California as FLIC. (RX-2, p. 2).

purchase of loans secured by perfected liens on new and used automobiles, light trucks, and recreational vehicles. (Id.).

Pruco's San Jose office held it's 1996 annual compliance meeting in August 1996. (CX-13, p. 4). Also in August of 1996, _____, an insurance agent and owner of an insurance agency, invited Respondent to a luncheon meeting to discuss the FLIC opportunity.[6] (Tr. pp. 163-164; CX-15, p. 2). In his presentation, _____ assured Respondent that the FLIC promissory notes were not securities.[7] (Tr. p. 164).

Respondent knew _____ solely by his reputation in the insurance industry. (Tr. p. 191). _____ was known as a big producer, selling fixed annuities to teachers, who were viewed as conservative, safety-conscious investors.[8] (Id.). In deciding to offer the FLIC notes to his customers, Respondent used the same process that he used in determining what insurance products to offer to his customers, i.e., the reputation of the issuer with other insurance agents. (Tr. p. 192).

After reviewing (i) the information that he received from _____ and (ii) the representations in the FLIC disclosure document, Respondent testified that he sincerely believed that the FLIC notes were not securities. (Tr. p. 183). On September 9, 1996,

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[6] _____ received Respondent's name from an insurance agent through which Respondent placed a health insurance policy. (Tr. pp. 163-164).

[7] _____ only had an insurance license. (RX-5, p. 1). _____ told Respondent that he did not have a securities license and had been selling the FLIC promissory notes to his customers for a year. (Tr. pp. 103-104, 165, 185; CX-15, p. 2). _____ also provided Respondent with a copy of an August 6, 1996 Dun and Bradstreet report, which indicated that FLIC had been in business since 1985 and was rated 3A3. (Tr. p. 165; RX-6, pp. 1-3). The Dun and Bradstreet 3A3 rating showed that FLIC, as of August 6, 1996, had a net worth between $1 million and $10 million and an overall fair credit appraisal. (RX-6, p. 2). _____ obtained the Dun and Bradstreet report as part of his due diligence of FLIC. (Tr. p. 165).

[8] _____ explained the FLIC business model to Respondent including the requirements that (i) the auto purchasers have at least a 20% down payment, (ii) they purchase collision insurance for the car, and (iii) they purchase gap insurance to cover the cost between the book value of the car and the outstanding balance on the loan. (Tr. pp. 116-117).

Respondent executed an agent agreement with FLIC. (CX-19, p. 1). Respondent executed his first FLIC transaction with customer KH on September 21, 1996. (Tr. p. 173; CX-17, p. 1). In late September 1996, Respondent briefly mentioned the FLIC notes to his Pruco supervisor, Kasparian.[9] (Tr. p. 178).

Kasparian was the managing director for Pruco's San Jose office.[10] (Tr. p. 22). Kasparian confirmed that Pruco's San Jose office consisted primarily of agents selling insurance, variable annuities, and mutual funds and confirmed that it was the common practice for agents to update Pruco as to their outside activities on an annual basis after the compliance meeting. (Tr. pp. 25-27, 181). With respect to Respondent's statement that he mentioned FLIC to her, Kasparian testified that it was possible he mentioned it to her, but she did not remember.[11] (Tr. pp. 39-40). Finding Respondent credible, the Hearing Panel believes that Respondent mentioned the FLIC notes to Kasparian.

Respondent completed his last FLIC transaction with customer KM on January 9, 1997.[12] (Tr. p. 193). In March 1997, _____ became concerned and visited FLIC's offices because FLIC was not making timely interest payments to some of his customers.

[9] Respondent advised Kasparian that he was involved in selling the FLIC product and that because it was a nine-month promissory note, it might be a product in which she should invest. (Tr. pp. 178-179). Kasparian decided not to invest. (Id.).

[10] Kasparian was the managing director of the San Jose Pruco office from 1992 to the third quarter of 1997. (Tr. p. 22). As the managing director she was head of the office and supervised between 25 and 35 agents. (Id.).

[11] Kasparian did discuss FLIC with Respondent after he was suspended in 1999. (Tr. pp. 23-24).

[12] Between September 1996 and January 1997, Respondent participated in the sale of $255,000 in FLIC promissory notes. (CX-4, p. 2).

(Tr. p. 109). In a March 10, 1997 letter, _____'s assistant suggested that Respondent suspend doing business with FLIC until some issues could be clarified.[13] (RX-4; Tr. pp. 139-140).

Although Respondent was no longer doing business with FLIC, at the 1997 annual compliance meeting, he listed FLIC on his November 10, 1997 amended Form U-4 because it was an entity with which he had done business in 1997. (CX-9, p. 2; Tr. pp. 177, 194). In November 1997, Korp,[14] the office manager of Pruco's San Jose office, was responsible for confirming that the San Jose Pruco agents updated their Form U-4s.[15] (Tr. p. 82). When adding FLIC to his amended Form U-4, Respondent orally advised Korp that he had sold FLIC promissory notes and that FLIC issued nine-month 10% promissory notes secured by automobile loans. (Tr. pp. 84-85, 194). Korp relayed this information to the interim managing director of the San Jose office, Wayne Stoeber. (Tr. pp. 81, 88-89). Korp testified that because the agents were not captive agents of Pruco, it was not normal for the managing director to know the names of the other companies with which the agents were affiliated. (Tr. pp. 93-94). Stoeber signed off on Respondent's amended Form U-4 that listed FLIC. (CX-9, p. 1).

Through the efforts of _____ and others, FLIC was forced into bankruptcy in April 1997. (Tr. p. 144). On August 20, 1999, counsel for the bankruptcy trustee for Boston Acceptance Corporation f/d/b/a FLIC wrote a letter to Respondent at his Pruco

[13] On April 4, 1997, _____ filed a complaint regarding FLIC with the Department of Corporations for the State of California. (RX-3, pp. 2-11).

[14] Korp joined Pruco in 1993. (Tr. p. 79).

[15] Although the Pruco Securities Compliance Overview provided that amendments to Form U-4s should be filed immediately for any new employment accepted outside of Pruco, Korp testified that it was customary for the San Jose agents to wait until the next annual meeting to disclose any new affiliations. (CX-12, pp. 3-4; Tr. p. 96).

office address demanding the return of his commissions on the FLIC promissory notes. (CX-4, pp. 1-2). In response to the letter, Respondent remitted his commissions. (Tr. p. 196).

Mohanco of Pruco's compliance department testified that, upon receipt of the August 20, 1999 letter, Pruco commenced an internal review of Respondent.[16] (Tr. p. 66). Pruco noted its investigation in its January 2000 Form U-5, which disclosed that Respondent terminated his association with Pruco on December 30, 1999. (CX-6, p. 4). Upon receipt of the Form U-5, the NASD staff began an investigation of Respondent. (CX-14). On August 8, 2000, NASD staff sent a request for information to Respondent. (Id.). On August 20, 2000, Respondent provided a complete written response to the NASD's August 8, 2000 request for information.[17] (CX-15).

C. Respondent Offered and Sold the FLIC Notes Without Prior Written Notice to, and Approval of, Pruco

Rule 3040 requires that an associated person who intends to participate in a private securities transaction, prior to the transaction, must "provide written notice to the member with which he is associated describing in detail the proposed transaction and the person's proposed role therein and stating whether he has received or may receive selling compensation in connection with the transaction . . . ." Further, if the transaction is for compensation, the member firm must approve or disapprove of the proposed transaction in writing.

[16] Mohanco joined Pruco in January 1997; she joined the compliance department in July 1998. (Tr. p. 54).

[17] On August 28, 2000, Mohanco provided a written response to an NASD August 9, 2000 request for information sent to Pruco. (CX-3; CX-4). Mohanco testified regarding the amended Form U-4s filed by Respondent. Although there was a dispute regarding the number of Form U-4 amendments provided by Respondent, there was no dispute regarding the relevant 1996 and 1997 Form U-4 amendments. (Tr. pp. 60-61).

Rule 3040 defines a "private securities transaction" as "any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission."

1. FLIC Notes were Securities

a. FLIC

FLIC represented that it was in the business of underwriting, purchasing, insuring, credit-enhancing, servicing and reselling high-yield retail automobile installment loan contracts.[18] (RX-2, p. 2). FLIC further represented that it had originated and sold over $25 million in insured retail automobile loans over the past ten years. (Id.). Some of the FLIC notes were offered pursuant to a Disclosure Document, dated November 1, 1996 and issued pursuant to a Trust Indenture and Security Agreement dated November 1, 1996 by and between FLIC and Sun Trust Banks of Florida, Inc.[19] (CX-22, p. 4).

The purchasers of the FLIC notes were limited to, among other things, individuals with (i) net worth of at least $1,000,000, or (ii) annual gross income during the previous two years of at least $200,000 per year, or (iii) joint income with spouse during the previous two years of at least $300,000 per year, and expectations to have at least that much gross income during the current year. (RX-1, p. 2).

[18] In addition to a security interest in FLIC's automobile loan portfolio, the FLIC notes were also to be partially secured by U.S. Government Securities, other investments of comparable safety, and cash reserves held to cover expenses, if any, incurred as a result of a default on an underlying loan. (CX-22, p. 1).

[19] Prior to the November 1996 Disclosure Document and Indenture, there was a Disclosure Document and Indenture naming Bank One as the Trustee. (Tr. pp. 172-173). The FLIC subscription agreement made reference to a Disclosure Document dated December 21, 1994. (RX-1, p. 1). The terms of the 1994 and the 1996 offerings were the same. (Tr. p. 138). The November 1996 Disclosure Document was not available to clients until January 1997. (Tr. p. 130).

In its Disclosure Document, FLIC represented that it did not advertise or make general solicitations to the public for its notes. (CX-26, p. 29). FLIC relied on purchaser agents that had an established clientele. (Id.). The purchaser agents were not allowed to characterize the FLIC notes as an investment; they were to use the term "commercial note." (Tr. p. 115). The FLIC notes had a minimum purchase requirement of $25,000, a term of 270 days, and bore simple interest at the rate of 10% per annum. (CX-22, p. 1). The 10% interest began accruing when the FLIC note's 10-day right-of-refund expired or was waived. (CX-26, p. 30). In its Disclosure Document, FLIC described its offering of the FLIC notes as a "Commercial Paper Placement." [20] (CX-22, p. 1).

b. Reves Analysis

Section 3(a)(10) of the Securities Exchange Act of 1934 ("Exchange Act")[21] includes in its definition of "security," "any note . . . but shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months."[22] While this language appears straightforward, the courts, in applying the definition of security, have completely replaced the literal language of both "any note" and the nine-month exemption with a transactional analysis.

The Supreme Court in Reves v. Ernst & Young, 494 U.S. 56 (1990), held that a note is presumed to be a security unless: (1) it bears a strong resemblance to certain types

[20] FLIC investors executed a subscription agreement, which stated, "I understand that I am purchasing a Commercial note." (RX-1, p. 1). Investors also executed a representation that referenced the "purchasing of commercial notes" several times. (RX-1, pp. 6-7).

[21] 15 U.S.C. 78c(a)(1).

[22] Section 2(a)(1) of the Securities Act of 1933 defines a security as "any note," and Section 3(a)(3) of the 1933 Act defines an exempt security as "any note . . . which arises out of a current transaction . . . and which has a maturity at the time of issuance of not exceeding nine months." The Supreme Court has consistently held that the definitions of a security in the 1933 and 1934 Acts are virtually identical and the coverage of the acts may be considered the same. Reves, 494 at 61 n.1.

of notes recognized, based on four factors, as being outside the securities investment market regulated under the securities laws,[23] or (2) it should be added, based on a balancing of the same four factors to that list of excluded notes.

The four factors to be considered when determining whether a note bears a strong resemblance to the type of notes recognized as excluded from the definition of a security are: (1) the motivations that would prompt a reasonable seller and buyer to enter into the transaction; (2) the plan of distribution of the notes; (3) the reasonable expectations of the investing public regarding whether the instruments are securities; and (4) the presence of any alternative scheme of regulation or other factor that significantly reduces the risk of the instruments so as to make regulation under the securities laws unnecessary.[24]

Considering the above four Reves' factors, the Hearing Panel finds that the FLIC notes do not resemble those promissory notes excluded from the definition of a security. First, FLIC entered into the transaction to raise funds for its business of purchasing automobile loans, and the investors loaned the money to FLIC with the expectation of profit based on the 10 percent interest rate.[25] Second, contrary to Respondent's argument that FLIC's plan of distribution did not involve a broad segment of the public because of the purchaser restrictions, _____ estimated that there were 400 agents and 4,000 note

[23] Reves listed the following notes as excluded from the definition of securities: notes delivered in consumer financing, notes secured by mortgages on homes, short-term notes secured by liens on small businesses or some of the small businesses' assets, notes evidencing "character" loans from banks, short-term notes secured by an assignment of accounts receivable, notes which simply formalize an open-account debt incurred in the ordinary course of business, and notes evidencing loans by commercial banks for current operations. See Reves, 494 U.S. at 65.

[24] Reves, 494 U.S. at 66-67.

[25] Reves emphasized that profit means a "valuable return on an investment" which "undoubtedly includes interest." Reves, 494 U.S. at 68 n.4. If the seller's purpose is to raise money for the general use of a business enterprise or to finance substantial investments and the buyer is interested primarily in the profit the note is expected to generate, the instrument is likely to be a "security." Id. at 66-67.

holders. Accordingly, the Hearing Panel finds that FLIC's plan of distribution was to a "broad segment of the public," demonstrating that there was "common trading" for speculation or investment.[26] Third, the Hearing Panel finds that despite the representations regarding commercial paper, the FLIC investors reasonably viewed the FLIC notes as alternative short term "investments" because of their short terms and the 10% rate-of-return. And finally, there is a clear need for the protection afforded by the federal securities laws, as no other regulatory scheme was in place to reduce the risk of the FLIC notes.[27]

The Hearing Panel also finds that under the second step of the analysis -- whether the FLIC notes should be added to the list of excluded notes, based on a balancing of the same four factors -- the four factors weigh heavily against the creation of a new category of note outside the protection of the federal securities laws. Accordingly, the Hearing Panel finds that the FLIC notes constitute securities under Reves.[28]

c. Commercial Paper Exemption

In Reves, the Supreme Court explicitly left open the question of whether the presumption that every note is a security applies to short-term notes. However, a number of circuits have determined that the presumption in favor of a security is not overcome

[26] Reves, at 68.

[27] The Hearing Panel noted that the insurance purchased by FLIC covered the vehicle loan contracts and not the FLIC notes. The Hearing Panel also noted that the loan contracts were not held by the Trustee but were held by the entity that actually serviced the loans. Accordingly, the note holders did not have a perfected security interest in the underlying loans.

[28] The California Commissioner of Corporations issued a Desist and Refrain Order dated October 28, 1999, which indicated the FLIC notes were securities within the meaning of the California Corporate Securities Law of 1968. (CX-21, p. 3).

merely because the term of a note, as here, is less than nine months.[29] The exclusion from the presumption is limited to commercial paper described as short-term high quality instruments issued to fund current operations and sold to highly sophisticated investors.[30]

The Hearing Panel finds that the Respondent failed to prove that the FLIC notes were the type of high quality instruments available for discount at a Federal Reserve Bank constituting commercial paper. Accordingly, the Hearing Panel finds that Respondent violated Conduct Rules 3040 and 2110 by selling securities to five customers, without the approval of Pruco.[31]

III. SANCTION

The NASD Sanction Guidelines for Private Securities Transactions provide for fines ranging from $5,000 to $50,000 and the adjudicator may increase the fine amount by adding the amount of respondent's financial benefit. The Guidelines also suggest that the adjudicator suspend the individual in any or all capacities for up to two years, and bar the individual in egregious cases.[32]

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[29] S.E.C. v. R.G. Reynolds, Enterprises, Inc., 952 F.2d 1125, 1133 (9th Cir. 1991).

[30] Sanders v. John Nuveen & Co., Inc., 463 F.2d 1075, 1079 (7th Cr. 1972), cert. denied, 409 U.S. 1009 (1972); In re NBW Commercial Paper Litigation, 813 F. Supp. 7, 16-18 (D.D.C. 1992); S. Rep. No. 47, 73rd Cong., 1st Sess, 3-4 (1933); H.R. Rep. No. 85, 73d Cong., 1st Sess., 15 (1993)(the legislative history of the Securities Act of 1933 indicates that the exemption was meant to apply to short term paper of a type which is rarely bought by private investors.)

[31] Although the Complaint alleged five completed transactions to four customers, Respondent testified that there were six transactions with five customers, verifying his earlier admissions to Pruco and the NASD staff. (CX-15, p. 2; CX-17, p. 1). Enforcement did not include customer NH on the ground that her funds were returned to her in March 1997 and the transaction was not completed. (Tr. pp. 204-205). Respondent testified that the March 1997 transaction was the second transaction for customer NH; the original transaction was in 1996. (Tr. pp. 212-213; CX-17, p. 1). Enforcement did note that Respondent was correct in his testimony that customer PL's transactions consisted of a $36,000 note and a $56,000 note rather than two $36,000 notes, as set forth in the Complaint. (Tr. p. 205).

[32] NASD Sanction Guidelines, p. 19 (2001).

Recognizing that this was not an egregious case, Enforcement recommended that Respondent be fined $10,000 and suspended for four months.

The Hearing Panel agrees that this is not an egregious case, and further finds that an appropriate remedial sanction for Respondent's misconduct is a $7,500 fine and a 30-day suspension. In determining the appropriate remedial sanction, the Hearing Panel considered the following five factors listed in the Guidelines for Private Securities Transactions:

> (1) whether the respondent had a proprietary or beneficial interest in, or was otherwise affiliated with, the selling enterprise;
>
> (2) whether the respondent attempted to create the impression that his employer sanctioned the activity, for example, by using the employer's premises, facilities, name, and goodwill;
>
> (3) whether the respondent sold away to customers of his employer;
>
> (4) whether the respondent provided his employer with verbal notice of all relevant factors;
>
> (5) whether the respondent sold the product at issue after prior rejection by the firm, a warning from a supervisor to stop sales, or some other prohibition of sales by the member firm.

The Hearing Panel found only two of the above five factors were somewhat aggravating. Although it was aggravating that two of the customers who purchased FLIC notes were customers of Pruco, the Hearing Panel noted that the customers used funds from their checking accounts to purchase the FLIC notes rather than funds from their Pruco accounts. (Tr. pp. 176, 198). In addition, it was aggravating that Respondent did not provide verbal notice of the details of his FLIC activities to his employer; however, Respondent did mention the promissory notes briefly to his managing director, albeit not in the context of seeking approval.

With respect to the other three factors, the Hearing Panel found that they were not aggravating. Respondent did not have a proprietary or beneficial interest in FLIC, the selling enterprise. There was no evidence presented that Respondent attempted to create the impression that his employer sanctioned the activity. Respondent did not sell the product in defiance of the firm's prohibition on such sales.

The Hearing Panel also found a number of mitigating factors.

1. Respondent received inadequate training and supervision

At the time that Respondent was involved in the selling of the FLIC notes, Respondent was registered as an investment company and variable products representative rather than a general securities representative. Accordingly, Respondent's primary activities involved the selling of insurance, but, more importantly, the training that he received from Pruco focused primarily on insurance.[33]

Although Respondent mentioned the FLIC notes to Kasparian, his managing director, she, not being a Series 7 registered representative, failed to follow-up on Respondent's disclosure in 1996 with the Pruco compliance department or others and failed to advise Respondent that there was a potential issue concerning the FLIC notes being securities.

This lack of adequate supervision was demonstrated again in 1997, when Respondent amended his Form U-4 to include FLIC and specifically advised Korp, his office manager, that he had participated in the sale of FLIC promissory notes. In 1997, Korp relayed this information to the interim managing director of the Pruco San Jose office, Walter Stoeber. (Tr. pp. 81, 88-89). No one from Pruco followed up on

[33] Respondent became a registered general securities representative in March 24, 1998. (CX-1, p. 3).

Respondent's disclosure. In fact, Pruco did not perceive that there was an issue until two years later, when it received the August 20, 1999 letter from FLIC's bankruptcy trustee.

2. Respondent did not intentionally or recklessly sell a security

Respondent's belief that the FLIC notes were not securities was consistent with the literal language of the exemption provided in the Exchange Act, _____'s assurances, and FLIC's Disclosure Document, which indicated that the FLIC notes were commercial paper. Further, the terms the FLIC notes and the offering, i.e., (i) a 10-day right-of-refund, (ii) representations that the FLIC notes were not to be advertised to the general public, and (iii) representations from the customers that they understood the FLIC notes to be commercial paper, appear to have been designed to convince agents, such as Respondent, that the FLIC notes were not securities.[34]

In addition, as discussed above, on two separate occasions, in 1976 and 1977 other San Jose Pruco employees, Kasparian and Korp, failed to perceive that the notes might be securities. In the absence of contrary information from Pruco, consistent with his insurance practice and procedure, Respondent, an independent insurance broker, relied on the recommendation of _____, an insurance agent with a good reputation in the industry, to determine whether to sell the product of a new entity. (Tr. p. 192). Respondent, relying on _____'s reputation, believed _____ when he indicated that he had investigated FLIC and determined it to be a credit-worthy entity and that the FLIC

[34] Respondent's agent agreement with FLIC prohibited Respondent from advertising the FLIC notes. (CX-19, p. 2).

notes were not securities. Accordingly, the Hearing Panel found that Respondent's misconduct was not intentional, reckless, or grossly negligent. [35]

3. Respondent executed a small number of transactions and did not attempt to conceal the transactions from Pruco

Although the misconduct extended over a five-month period, there were only six transactions completed. Respondent did not attempt to conceal his conduct. Pruco was responsible, in part, for Respondent's delay in providing written notice of his participation in the FLIC note sales in 1996.[36] Consistent with the practice and procedure of Pruco's San Jose office, at the next compliance meeting, Respondent discussed the FLIC notes with Pruco and completed an amended Form U-4, listing FLIC.

4. Respondent expressed remorse and promptly relinquished his FLIC commissions

Respondent immediately ceased soliciting the FLIC notes when _____ indicated that there might be a problem. Respondent also promptly relinquished his commissions to FLIC's receiver when requested to do so.[37] (Tr. p. 196). The Hearing Panel was also favorably impressed with Respondent's remorse and sincerity.[38] Korp testified that Respondent was one the most outstanding Pruco agents and she held him in very high regard. (Tr. pp. 96-97). The Hearing Panel views Respondent as a truthful and trustworthy man who is not likely to engage in similar misconduct in the future.

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[35] Respondent was negligent in executing a FLIC representative compliance declaration that indicated he had advised his employer of his participation in the FLIC transactions. (CX-20, p. 2).

[36] Although Pruco's written policies indicated that an amended Form U-4 should be filed immediately, in Pruco's San Jose office, it was general practice and procedure in 1996 to have its agents file their amended Form U-4s annually.

[37] FLIC note holders will recoup between 44% and 74% of their funds depending on whether the trustee was Bank One or Sun Trust Bank. (Tr. p. 144).

[38] Respondent testified that knowing what he knows now, he would never become involved in similar transactions in the future. (Tr. pp. 198-199).

IV. Conclusion

The Hearing Panel fines Respondent Chris Dinh Hartley $7,500 and suspends him for 30 calendar days in all capacities. In addition, Respondent is ordered to pay the $2,059.86 hearing costs, which include an administrative fee of $750 and hearing transcript costs of $1,309.86. These sanctions shall become effective on a date set by the NASD, but not earlier than 30 days after this decision becomes the final disciplinary action of the NASD, except that if this decision becomes the final disciplinary action of the NASD the suspension shall become effective with the opening of business on Monday, January 6, 2003 and end at the close of business on Wednesday, February 5, 2003.[39]

SO ORDERED

HEARING PANEL

By:_____
Sharon Witherspoon
Hearing Officer

Dated: Washington, D.C.
November 5, 2002

Copies to:
Chris D. Hartley (via Airborne Express and first class mail)
David A. Watson, Esq. (via electronic and first class mail)
Rory C. Flynn, Esq. (via electronic and first class mail)

[39] The Hearing Panel considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.