NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF MARKET REGULATION, Complainant, v. KO SECURITIES, INC. (CRD #8364), Seattle, WA and TERRANCE YOSHIKAWA (CRD #474700), Seattle, WA Respondents.	Disciplinary Proceeding No. CMS000142 Hearing Officer - JN **HEARING PANEL DECISION** October 15, 2001

Member firm and associated person violated Rules 3370 and 2110 by short selling without making and annotating affirmative determinations. Respondents fined $147,450.81. Member firm also fined $15,000 for failing to keep a record of the terms and conditions, time of entry, and time of execution of trades, in violation of SEC Rule 17a-3 and NASD Conduct Rule 2110.

Appearances

For the Complainant: David H. Katz, Laurie A. Doherty, and Rory C. Flynn.

For the Respondents: Terrance Yoshikawa appeared pro se for both Respondents.

DECISION

I. Introduction

On May 4, 1998, Ko Securities, Inc. ("Ko"), through its President, Terrance Yoshikawa, sold short more than 46,000 shares of EntreMed, Inc. ("ENMD"). The Department of Market Regulation filed a Complaint on July 6, 2000, against the firm and Mr. Yoshikawa, alleging various violations involving these transactions.

The First Cause of the Complaint alleged that Respondents violated NASD Conduct Rules 3370 and 2110 by executing the short sale transactions without making and annotating "affirmative determinations," as required by Rule 3370. The Second Cause charged them with violating Regulation T (promulgated by the Board of Governors of the Federal Reserve System) and NASD Conduct Rule 2110 by executing short sale transactions in customer cash accounts. The Third Cause alleged that the firm violated NASD Conduct Rules 3110(b)(1) and 2110 by failing to properly identify customer sell order tickets, pertaining to ENMD securities, as short sales. The Fourth Cause alleged that the firm violated SEC Rule 17a-3 and NASD Conduct Rule 2110 by failing to maintain a record of the terms and conditions, time of entry, and time of execution of brokerage orders for ENMD securities.

A Hearing Panel, consisting of an NASD Hearing Officer, a current member of the NASDR's District 3 Committee, and a current member of NASDR's Market Regulation Committee conducted the hearing in Seattle, Washington on May 30 and 31, 2001. Market Regulation presented twenty-five exhibits (C-1 through C-25)[1] and

[1] Exhibit C-24 was marked for identification, but not offered.

testimony from one witness. Respondents presented one exhibit (R-1) and testimony from four witnesses, including Mr. Yoshikawa.

II. Background

Respondent Ko Securities, Inc. was and is a broker-dealer, registered pursuant to the Securities Exchange Act of 1934, and a member of the NASD (Stipulation, ¶1). Respondent Yoshikawa, the firm's founder and sole shareholder, served as its President during the period in question and continues to serve in this capacity (Stipulation, ¶4; Tr. 403). Mr. Yoshikawa has been registered with the NASD and associated with Ko as a general securities principal, financial and operations principal, and options principal since 1980 (Stipulation, ¶5).

ENMD is a biopharmaceutical company that was developing a product, which it described as "inhibit[ing] abnormal blood vessel growth associated with a broad range of diseases such as cancer, blindness, arthritis and atherosclerosis" (C-1, p. 1). On Sunday, May 3, 1998, The New York Times published an article headlined "A Cautious Awe Greets Drugs That Eradicate Tumors in Mice," which reported medical research showing new drugs that appeared to cure cancerous tumors in mice and stated that "Entremed is working as fast as it can to produce [the drugs] for studies in humans" (C-3, p. 5).

That night and the next morning (May 4, 1998), Mr. Yoshikawa contacted several Ko employees or relatives of employees and took their orders for ENMD stock (C-25, pp. 165-171). He and these customers thought that the price would rise and they gave him "time and price discretion to purchase the stock" in certain amounts (Id.; Tr. 323). On May 4, ENMD's share price, which had closed at $12 on May 1, opened at $83 (Stipulation, ¶10). After the market opened, Mr. Yoshikawa believed that the stock was overpriced because the experiments had involved only animals (C-25, pp. 175-176, 206-207). His firm then began short selling ENMD shares (C-10).

At or about the time of these sales, Mr. Yoshikawa asked a Ko employee to send a wire to its clearing firm, PaineWebber,[2] requesting permission to short ENMD shares (Stipulation, ¶16). PaineWebber denied Ko's request to borrow the ENMD shares at approximately 11:00 a.m. or 12:00 noon E.S.T. (Stipulation, ¶17). After receiving the denial from its clearing firm, Ko continued to short sell ENMD throughout the day of May 4 (Tr. 131-132; C-10). Mr. Yoshikawa acknowledged short sales of 46,700 shares for that day (Tr. 76, 77, 115; C-25, pp. 214-215, 223).[3]

The stock declined sharply at various points during May 4, and the short sales were profitable (C-4; C-23). At the end of the day, according to Mr.Yoshikawa and his vice-president, the customers received their share of the profits by purchasing the ENMD shares from the firm, paying averaged prices, and then selling them back to Ko (Tr. 78-80, 318, 330, 435-437). Under any view of the facts, Mr. Yoshikawa effectively distributed the short sale profits to the customers' cash accounts, as well as to his and the firm's margin accounts (C-18, pp. 24-28; C-20; C-23).[4] The prosecution makes no contention that the method by which Respondents distributed the profits was improper.

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[2] Ko clears its trades through Correspondent Services Corporation ("CSC"), a PaineWebber affiliate. For purposes of this opinion, the clearing firm will be referred to as PaineWebber.

[3] Market Regulation's evidence showed short sales of 58,600 shares (Tr. 106, 110). The difference between 46,700 and 58,600 is immaterial for purposes of the violations charged here.

[4] Mr. Yoshikawa explained that he used a price averaging system to give the customers the benefit of the best execution, ahead of himself (Tr. 75, 78). As later discussed, Market Regulation relies on the distribution as proving that the short sales occurred in cash accounts and were, therefore, illegal under Regulation T. It makes no contention that the method of distribution was in any way unfair.

III. Liability

A. The Affirmative Determination Violations

A "short sale" is "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller" (SEC Rule 3b-3). Pursuant to NASD Rule 3370(b)(2), the requirements for such sales differ, as between "customer short sales" and "proprietary short sales." For customer sales (i.e. sales "for any customer"), the member or associated person must make "an affirmative determination that the member will receive delivery of the security from the customer or that the member can borrow the security on behalf of the customer for delivery by settlement date." If the short sale is for the member's "own account," the member or associated person must make "an affirmative determination that the member can borrow the securities or otherwise provide for delivery of the securities by the settlement date" (Id.; emphasis added). [5]

Respondents contend that the short sales in issue were proprietary, thereby triggering the "otherwise provide for" clause, and that they satisfied that requirement because Mr. Yoshikawa later found the stock to cover the sales. Market Regulation argues that the transactions were customer sales, but that Respondents are liable even if the transactions were proprietary because the "otherwise provide for" language requires pre-sale assurance, not after-the-fact discovery of the stock.

The first question is whether the transactions were customer or proprietary sales. The records pertaining to the sales show that each occurred in an account designated as "TAPS," an abbreviation for "a trade allocation and omnibus processing account" (C-6;

[5] As explained by Market Regulation, the short-selling firm typically obtains a commitment from a clearing firm that the shares will be there when the selling firm needs them (Tr. 29-30).

Tr. 106). The staff argued that the TAPS account was a "firm account whose purpose is nothing more than to facilitate allocation of shares and average pricing" (Tr. 208). Mr. Yoshikawa also described that TAPS account as a "trade allocation" or "trade averaging" account, which was "interchangeable" with "our inventory accounts" (Tr. 81, 317). As he explained: "[t]hey're one and the same whether it says TAPS or inventory, they [the sales] are done there and then the TAPS account is a subpart of the inventory account. That's the account that allows you to price average…" for distribution to customers (Tr. 317).

It is undisputed that Mr. Yoshikawa ultimately credited profits from the short sales to individual customer accounts. That he used the TAPS account as a step in transferring those profits into customer accounts did not, however, convert the underlying transactions into customer short sales. On the face of the records, the sales occurred in the firm's TAPS account, not in any individual customer's account.

Treating the customers as actually making short sales would be contrary to their authorization to Mr. Yoshikawa to buy ENMD stock, based on their belief that the market would rise on news linking ENMD to cancer-curing drugs. Mr. Yoshikawa repeatedly testified that prior to the opening he had solicited the customers to buy the stock, that they gave him "time and price discretion as to the amounts of money we could use," and that all were under the impression that he would buy the stock for them (Tr. 323, 361, 368). The one customer who testified was a former Ko employee (Mrs. DeMers), who was now employed as an examiner in NASD's Seattle office. Her testimony that Mr. Yoshikawa solicited her to buy, not to short sell (Tr. 289-290) was consistent with his position that the short sales occurred in the firm's account (as the records show) and not in the customers' accounts.[6]

In the Panel's view, these were optimistic customers who wanted Mr. Yoshikawa to buy the stock for them. There is no evidence that they authorized short sales, anticipating a decline in the market. Indeed, Mr. Yoshikawa testified that if the market had turned up, he, not the customers, would have absorbed the loss (Tr. 388). But if the customers were making the short sales, as Market Regulation contends, they, not Mr. Yoshikawa, would have sustained the losses. In the Panel's view, he used the company's TAPS account for short sales, intending to give relatives and employees the benefit if the transactions were profitable, while leaving him to bear the risk of any losses. That he may have had this potential benefit for specific customers in mind while using the proprietary account does not convert the transactions into customer short sales.

It is true that Mr. Yoshikawa's investigative testimony contains a statement that the stock was "shorted out of" his and his mother's account (C-25, pp. 174-175). At the hearing, he testified that subsequent check of the relevant records showed that the transactions were done in the company's TAPS account, and not in customer accounts, explaining that the prior testimony was the product of repeated questioning, which confused him and produced an erroneous answer (Tr. 328-330). The Panel accepts his hearing testimony. The transcript of the investigative testimony shows that Mr.

[6] Mr. Yoshikawa called as his witnesses two current NASD employees: Mrs. DeMers and Mr. Perez, another examiner. Mrs. DeMers testified that Mr. Yoshikawa always gave his customers the best execution and, as noted, supported the view that the short sales were his, not the customers'. At the same time, she candidly acknowledged the firm's shortcomings concerning its records (Tr. 277). Mr. Perez also spoke to recordkeeping deficiencies, explaining that a prior Letter of Caution dealt with the firm's failure to document such affirmative determinations, and not with the "otherwise provide for" requirement (Tr. 255, 264). That testimony mitigates the affirmative determination violation, but aggravates the recordkeeping violation. In short, some of the NASD employees' testimony helped the defense, and some of it did not. The Panel found these witnesses to be fairly balanced, and generally corroborated by documents.

Yoshikawa's decision to proceed without counsel was not easy (C-25, pp. 5-7). He testified at the hearing that "[w]hat I said maybe was incorrect, but…I didn't study material to come to the deposition; I just came to the depositions" (Tr. 499). His hearing testimony was corroborated by tickets which show the transactions as occurring in the firm's TAPS account, not in individual accounts; by his uncontradicted testimony as to soliciting purchases of the stock; by the absence of evidence that any customer authorized a short sale; and by the testimony of one customer that he had solicited her to buy, not to short sell.

That he had customers in mind as ultimate beneficiaries of any profits is not inconsistent with his using the proprietary account to effect the short sales. As the Association has recognized, albeit in a different context, "a dealer purchasing or selling for its own proprietary account is usually doing so to fill a customer order…."[7] As noted, the firm's records showed the trades as occurring in the TAPS account, which Mr. Yoshikawa described as an "inventory account" used to allocate and average trades. His testimony was corroborated by Ms. Yakushijin, the firm's vice president, and by Mrs. DeMers, each of whom stated that the trades occurred in the TAPS account, which they described as an inventory or proprietary account that facilitated price averaging and customer orders (Tr. 291, 294, 311, 434). There was no direct evidence that the trades in fact occurred in customers' account. On this record, the Panel finds that the transactions in issue were proprietary short sales.

The question under Rule 3370(b)(2)(B) is, therefore, whether Respondents made an affirmative determination that they could "otherwise provide for delivery of the securities by the settlement date" as required by the above Rule. Market Regulation

[7] Notice to Members 91-69, 1991 NASD LEXIS 93 at *8 (November, 1991).

argues that this step must be performed before, not after, the short sale, and that Respondents' post-hoc discovery of the shares thus violated Rule 3370(b)(2)(B). Respondents say that they complied with the "otherwise provide for" requirement by finding the stock at the end of the day.

The history of that Rule shows, as Market Regulation contends, that the "otherwise provide for" requirement demands more than after-the-fact discovery of the needed securities. In the Panel's view, that language requires assurance before, not after, the proprietary short sale.

In 1988, NASD solicited views on a proposal to add the language in question as a requirement for members who were effecting proprietary short sales (Notice to Members 88-47, July, 1988). That Notice summarized the proposal, which included the "otherwise provide for" language, as requiring that a member "make an affirmative determination, <u>before effecting a short sale for its own account</u>, that the security will be borrowed or delivered prior to the settlement date" (<u>Id.</u>, emphasis added).

In April of 1989, the SEC published the proposal for comment, stating that the amendment addressed "unnecessary speculation in connection with the short selling of broker dealers' proprietary positions caused by the members' ability to go short without securities to cover the short positions" (54 Fed. Reg. 18185, April 27, 1989). The Commission explained that the proposal required members to "make an affirmative determination that they can borrow a security or otherwise provide for delivery of the security…<u>before effecting short sales for their own account</u>" and that it would "enhance the integrity of the market…." (<u>Id.</u>, at 18186). Later that year, after changes not relevant here, the SEC re-published the proposal, repeating the above-quoted language from its

April Notice (54 Fed. Reg. 46665-46666, November 6, 1989). The SEC ultimately approved of this amendment governing proprietary short sales, noting inter alia that it "will impose additional discipline on short selling and thereby increase the ability to maintain a fair and orderly market" (55 Fed. Reg. 28703, July 12, 1990).

Since adopting the Rule, the SEC and NASD have consistently interpreted it as requiring that firms determine the availability of the securities before executing a short sale. In 1993, reciting the background for various short sale regulations, the SEC stated that the NASD "requires a member to make an affirmative determination that it can borrow the security before effecting a short sale for its own account" (58 Fed. Reg. 39072, July 14, 1993). As pointed out by Market Regulation, the NASD's March 1998 Compliance Report, issued to all members, stated that "NASD Regulation reiterates its long-standing position that firms must make an affirmative determination for ***all*** short sales prior to executing the sale" (Reminder of the Affirmative Determination Requirements, NASD Regulation, Regulatory Compliance Alert, Vol. 12-1 (March 1998), at 36; C15; emphasis in original).

The argument that the "otherwise provide for" requirement envisions after-the-fact discovery of the necessary shares sharply contradicts the above-repeated statements by the Commission and the Association that the necessary assurance must precede the short sale. The notion that a firm may comply if it fortuitously finds the stock at the end of the day injects inherent uncertainty into proprietary short sales and is, therefore, wholly inconsistent with the underlying goals of "additional discipline on short selling" and protecting marketplace integrity.

In the present case, as noted, Respondents did not find the shares sold short until after-the-fact. That is too late under Rule 3370(b)(2)(B). The Panel thus concludes that Respondents violated that Rule and Rule 2110 by failing to make and annotate an advance determination that the stock would be available to cover the firm's proprietary short sales.

B. The Regulation T Violations

Regulation T was promulgated by the Board of Governors of the Federal Reserve System primarily "to regulate extensions of credit by brokers and dealers" (Regulation T, Sec. 220.1). Section 220.8 of that Regulation, describing permissible transactions in cash accounts, omits any reference to short sales. The parties agree that such sales cannot be executed in cash accounts (Tr. 335, 477). The Complaint's Second Cause alleges that the firm violated that Regulation by executing short sales in customer cash accounts.

It is undisputed that several customer cash accounts were the ultimate recipients of the profits from the short sales executed in the firm's TAPS account (C-23). Emphasizing that fact, Market Regulation contends that the Respondent firm violated Regulation T by executing short sales in cash accounts. The Panel disagrees.

For Regulation T purposes, the Board of Governors defined a "cash account" as "one in which customer transactions are effected with the understanding that they will be settled…within the three business days established as the standard time period for settling transactions in most securities" (Memorandum, reprinted in NASD Manual, at p. 8382; emphasis added). The threshold question is, therefore, whether the short sales in issue were "effected" in customer cash accounts.

The order tickets reflecting the various short sales all showed the "customer" as TAPS (C-6), a company account used to facilitate transactions, not a customer cash account. The record is consistent with Mr. Yoshikawa's testimony that the short sales were done in the firm's inventory or TAPS account (Tr. 317).[8] There is no record of short sales in the customer accounts. The statements, order tickets, and confirmations involving the allocation of profits to those accounts show long purchases and sales of the stock in question, as Mr. Yoshikawa testified, and not short sales (C-9; C-19). The supposed short sales in customer accounts are simply not corroborated by any of the relevant records.

The hypothesis that Mr. Yoshikawa was making short sales in customer accounts was also inconsistent with the customers' own intentions. There was no evidence that they authorized or even considered short sales. One customer, now an NASD employee, testified that Mr. Yoshikawa had solicited her to buy the stock, not to sell it short (Tr. 289-290). Respondent explained that he recommended the stock to the relevant employees and family and obtained "time and price discretion to buy the stock" (Tr. 323). There was no evidence that he even suggested short sales, let alone had the customers' authorizations for such transactions.

Regulation T's "principal purpose is to regulate extensions of credit by brokers and dealers…" (Regulation T, Sec. 220.1(a)), a purpose not involved here. There is no evidence that Mr. Yoshikawa extended any credit to the customers. As noted, they thought that they were buying stock, not "borrowing" to sell short. There is no evidence

[8] At one point in his investigative testimony, Respondent referred to the TAPS account as an account which "facilitates" but does not "do the trade" (C-25, p. 178). During the hearing, he explained that the TAPS account was part of the "inventory account" in which the trades were actually executed (Tr. 331-332). Mr. Yoshikawa explained that he was confused during the pre-trial interview (Tr. 330). The Panel finds that any difference in these descriptions is of no significance.

that they authorized any transaction involving "extensions of credit" from Respondent, or that he in fact extended any credit to them. Indeed, Mr. Yoshikawa testified that if the stock price had risen, he would have personally covered the short sales and taken the losses, using his own funds or refinancing certain real estate (Tr. 388-391). Because the evidence shows that the customers did not authorize short sales, Mr. Yoshikawa could not have passed any losses through to them, even if he wanted to do so. These acts are wholly inconsistent with the notion that he was extending credit to the customers.

For all of the above reasons, the Panel finds Regulation T inapplicable to the facts of this case.

C. <u>The Recordkeeping Allegations</u>

1.) Customer tickets marked "long" (Third Cause)

The Complaint's Third Cause alleges that Respondent Ko Securities improperly marked the relevant customer tickets as "long" when they should have reflected "'short' sale orders" (Complaint, pars. 19-21). The Panel disagrees with the contention that the customer tickets should have reflected short sales. As explained above, the Panel finds that the short sales occurred in the firm's TAPS account, not in individual customer accounts. It is true that the short sales were profitable and that Mr. Yoshikawa ultimately distributed a share of those proceeds to the customers (using "long" tickets to reflect their later purchases and re-sales of the stock). The tickets reflecting those profit distributions, however, were correctly marked as "long." The customers did not authorize short sales in their accounts and none was effected in such accounts. The Panel therefore finds that Market Regulation failed to prove this alleged recordkeeping violation.

2.) Failure to maintain terms, conditions and time of entry (Fourth Cause)

SEC Rules 17a-3(a)(6) and (7) require records showing the time of receipt, terms and conditions, and time of entry of customer orders. The tickets which Mr. Yoshikawa used as vehicles to distribute the ENMD short sale profits to his employees and relatives (C-19) did not reflect such information. Indeed, he admitted that the records prepared by Ms. Sharon DeMers, his former employee, did not reflect times of entry and recognized that "[t]here's possibly some minor recordkeeping violations where Sharon marked tickets" (Tr. 344-345, 439, 506). The Panel finds that the firm violated SEC Rule 17a-3 and NASD Rule 2110, as charged under the Complaint's Fourth Cause.

IV. Sanctions

A. Affirmative Determination

The Sanction Guidelines for short sale violations recommend a scale of fines: $1,000 to $2,000 for a "first action," $2,000 to $10,000 for a "second action," and $5,000 to $100,000 for "subsequent actions" (NASD Sanction Guidelines (2001 ed.), p. 70). Adjudicators may increase this base fine by adding (1) the amount of a respondent's financial benefit, or (2) in egregious cases or those involving "willful misconduct," any profit realized by the short-selling customer. In egregious cases, the Guidelines further recommend considering "suspending the responsible individual…for up to two years or expelling the firm and/or barring the responsible individual" (Id.).

Arguing that this case is not a "first action" because the short sale violations involve several transactions which constitute separate "actions" (Tr. 418, 491-492), Market Regulation seeks a fine of at least $10,000, plus the total of the profits attributable to all of the short sales – i.e. $539,114.93 (C-23; Tr. 414, 418, 490-493).

The first question is thus whether this proceeding constitutes a "first action" for purposes of establishing the base fine. The Guidelines define "action" as "a formal disciplinary action," including "a Letter of Acceptance Waiver and Consent (AWC), a settled case, a Minor Rule Violation Plan Letter, or a fully litigated case" (Guidelines, supra, at p. 12). Respondents' disciplinary history reflects only a Letter of Caution (issued in April of 1998, concerning other matters), which the Guidelines expressly exclude from the definition of "action" (Id.). The Guidelines make clear that for present purposes, an "action" is a proceeding, not a series of allegations in a Complaint. In the Panel's view, the instant case is a "first action" and the maximum recommended basic fine for such an action ($2,000) is appropriate here.

Insofar as Market Regulation seeks to augment that fine by the Respondents' own profits, its position is persuasive. The Guidelines authorize a panel to enlarge the fine by adding "the amount of [the] respondent's financial benefit" (Id., at 70, fn. 1). Such a result is appropriate here. As discussed above, Rule 3370 requires some form of advance assurance of the ultimate availability of the securities involved in proprietary short sales. Such a requirement protects the selling firm, its clearing firm, and the buyer and supports the integrity of the short sale marketplace. Respondents should not be allowed to profit from their own failure to comply with that requirement. The record shows that Mr. Yoshikawa and his firm realized profits of $9,806.66 and $135,644.15, respectively, from the short sales (C-23). The total fine will thus be $147,450.81 ($2,000 for this first action plus $9,806.66 and $135,644.15 for profits). The Panel intends that Mr. Yoshikawa and Ko Securities shall be jointly and severally liable for payment of this fine.

In the Panel's view, Market Regulation's attempt to expand the fine still further by adding each of the other customers' profits is inappropriate. The Guidelines recommend such a step "in egregious cases or those with evidence of willful misconduct" (Guidelines, supra, at p. 70). Mr. Yoshikawa's reliance on the "otherwise provide for" delivery language in Rule 3370(b)(2)(B) reflects a misunderstanding of the Rule, but not deliberate or willful misconduct. He testified, without contradiction, that at least three other firms also read the language as meaning that a post-short sale acquisition of the stock on the same day would satisfy the requirement (Tr. 365, 393-394, 397). A Letter of Caution issued to Mr. Yoshikawa several weeks before the events in issue involved a failure to record affirmative determinations, but not compliance with the requirement itself; the NASD's examiner could not recall specific conversations with Mr. Yoshikawa concerning that requirement (C-16; Tr. 247-248, 255, 264). There is no evidence that Respondents acted in deliberate disregard of the Rule. Nor was the misconduct the result of any premeditated plan. Mr. Yoshikawa began the day intending to buy the securities; short sales occurred only after the market opened and he concluded that the stock was overpriced. In the Panel's view, adding the profits of all of the other customers – thereby increasing the fine by several hundred thousand dollars – would be more punitive than remedial (See Guidelines, supra, at p. 3). Under all of these circumstances, the Panel does not find the circumstances egregious or willful, so as to justify enlarging an already-substantial fine by adding all customer profits.

Market Regulation does not seek suspensions or bars (Tr. 414), and the Panel sees no reason to impose such sanctions.

B. Recordkeeping

For recordkeeping violations, the Sanction Guidelines recommend that adjudicators fine the firm $1,000 to $10,000 and consider a suspension for up to 30 business days (Guidelines, supra, p. 34). In egregious cases, the Guidelines recommend a fine of $10,000 to $100,000 and a suspension of up to two years or expulsion (Id.).

Market Regulation recommends a fine of $5,000 (Tr. 406). The Panel finds that a larger fine is appropriate. The Guidelines mention the "nature and materiality of…[the] missing information" as principal considerations in determining recordkeeping sanctions (Id.). In the instant case, the firm's failures to record the requisite details forced the staff to attempt to re-create the transactions and trace them into and out of accounts. Proper records would have contributed to a better understanding of what did or did not happen. Whether they would have strengthened the Department's contention or corroborated Mr. Yoshikawa's account, the deficiencies were significant in the context of this case. In the Panel's view, recordkeeping violations which frustrate the adjudicatory process are not "minor" as Mr. Yoshikawa claimed (Tr. 439).

Moreover, the firm's attitude toward required records was casual at best. Before the transaction in issue, the NASD issued a Letter of Caution to the firm concerning its failure to retain records of affirmative determinations. Mrs. DeMers, who worked for Mr. Yoshikawa for many years (and is now employed by NASD), testified that the firm was not as careful as it should have been with affirmative determination records and that she checked a "firm to lend" box on records pertaining to the instant transactions because she did not know what else to check (Tr. 277-278, 296). Mr. Yoshikawa himself explained the absence of requisite records by stating "we had other things to do than to write tickets that morning" (Tr. 335). In these circumstances, the Panel finds that the firm's recordkeeping violations were egregious and fines it $15,000.

V. Conclusion

Respondents Yoshikawa and Ko violated NASD Conduct Rules 3370 and 2110 by effecting short sales without making and annotating the affirmative determinations required for each short sale. Respondents will be fined $2,000 for this "first action" offense. This fine shall be augmented by Respondents' profits from the short sales, consisting of $135,644.15 in the firm's account and $9806.66 in Mr. Yoshikawa's account. The total fine, for which Respondents will be jointly and severally liable, will, therefore, be $147,450.81.

Respondent Ko also violated SEC Rule 17a-3 and NASD Conduct Rule 2110 by failing to maintain a record of the terms and conditions, time of entry, and time of execution of each brokerage order. Respondent Ko is fined $15,000 for this violation. These sanctions shall become effective on a date set by the Association, but not earlier than 30 days after the final disciplinary action of the Association. In addition, a total of $3,531.26 in costs ($2,781.26 for transcripts and a standard $750 administrative fee) will be imposed jointly and severally against Respondents Yoshikawa and Ko.[9]

HEARING PANEL

By: Jerome Nelson
Hearing Officer

Dated: Washington, DC
October 15, 2001

[9] We have considered all of the arguments of the parties. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed herein.

Copies to: Terrance Yoshikawa (via overnight delivery and first class mail)
Ko Securities, Inc. (via overnight delivery and first class mail)
David H. Katz, Esq. (via electronic mail and first class mail)
Laurie A. Doherty, Esq. (via electronic mail and first class mail)
Michael Wolk, Esq. (via electronic mail and first class mail)
Rory C. Flynn, Esq. (via electronic mail and first class mail)