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NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. CAF980080
v.	:	**HEARING PANEL DECISION**
	:	Hearing Officer – JN
	:	May 6, 1999
Respondent.	:	

Digest

The Department of Enforcement filed a Complaint alleging that Respondent ______________ violated (1) Section 17(a) of the Securities Exchange Act of 1934, (2) Rule 17a-5 thereunder, and (3) NASD Conduct Rule 2110, by failing to file its Form BD-Y2K in a timely manner. The Hearing Panel found that Respondent committed the violation charged in the Complaint. As to sanctions, the Hearing Panel imposed a censure and a fine of $2,500. The Hearing Panel also ordered Respondent ______________ to pay costs in the amount of $1,069.95 consisting of $750 for the cost of the Hearing and $319.95 for the cost of the Hearing transcript.

Appearances

Jonathan Golomb, Senior Attorney, Washington, D.C. (Rory C. Flynn, Chief Litigation Counsel, Washington, D.C., of counsel), for the Department of Enforcement.

____________________, for the Respondent.

DECISION

I. Introduction

The Department of Enforcement filed its Complaint against Respondent ______________ on October 20, 1998, alleging that it violated Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-5 thereunder, and NASD Conduct Rule 2110 by failing to file a Form BD-Y2K in a timely manner. A Hearing Panel, composed of an NASD Hearing Officer, one current member of the District Business Conduct Committee for District 10, and one former member of that Committee, conducted a hearing in New York on March 18, 1999. The parties presented a Joint Stipulation and six Joint Exhibits; Enforcement introduced two exhibits.[1] Respondent presented testimony from __________ the principal and sole employee of ______________

The Panel finds that Respondent ______________ failed to timely file its Form BD-Y2K, as alleged in the Complaint. For sanctions, the Panel imposes a censure and a fine of $2,500.

II. Facts

The relevant provision of SEC Rule 17a-5(e)(5) required broker-dealers to file Form BD-Y2K with the NASD and the SEC by August 31, 1998 (Joint Stip. ¶ 3). Respondent ______________, a New York City broker-dealer and NASD member, was among those required to file the Form (Joint Stip. ¶ 1, 3). The NASD notified its members of the Rule's

[1] The Transcript of the Hearing is cited as "Tr.-"; the Joint Exhibits are cited as "JX-;" the Joint Stipulations are cited as "Joint Stip. ¶ __"; and Enforcement's exhibits are cited as "CX-".

requirements by a series of mailings sent to the firms' Central Registration Depository addresses (Joint Stip. ¶ 4).

By letter dated July 16, 1998, the NASD notified member firms of the SEC Rule Amendment involving the Form BD-Y2K filing requirements (Joint Stip. ¶ 4(a); JX-1). The letter stated inter alia that "[t]he amendment requires all NASD members with FOCUS capital requirements ... of $5,000 or greater to file two reports with the SEC and the firm's designated examining authority (DEA). The first report is due to the SEC and the DEA on or before August 31, 1998" (JX-1). The letter also contained the dates and times that NASD and SEC staff would be available in various cities to answer questions regarding the Form (JX-1).

On or about July 29, 1998, the NASD mailed Special Notice to Members 98-63 to member firms (Joint Stip. ¶ 4(b); JX-2). The Special Notice reiterated the information disclosed in the earlier letter and stated (in boldface type) that: "[t]he first report is due to the SEC and the DEA on or before August 31, 1998" (JX-2).

On or about August 15, 1998, the NASD mailed a brochure entitled "NASD Year 2000 Member Information" to its members (Joint Stip. ¶ 4(c); JX-3). This brochure again stated that the BD Y2K filing obligation required "all NASD members with FOCUS capital requirements … of $5,000 or greater to file two reports …. The first report is due to the SEC and DEA on or before August 31, 1998" (JX-3). The brochure also provided answers to "Year 2000 Frequently Asked Questions"; listed "Year 2000 Reference Sites," containing internet web sites pertaining to the Year 2000 problem; and furnished the name, address, e-mail address, and toll-free telephone number of the Program Director of the Association's Year 2000 Program Office (Id.).

On September 11, 1998, after ______________ failed to file its Form BD-Y2K on time, the Department of Enforcement sent an express mail letter to ______________, the firm's principal and sole employee (Joint Stip. ¶2; JX-4). The letter stated that Respondent had not yet filed, and that in order to avoid disciplinary action, the Form had to be filed with the NASD by September 21, 1998 (Joint Stip. ¶ 8; JX-4). On September 17, 1998, _______ had a telephone conversation with an NASD employee, where he and the employee discussed the Form BD-Y2K filing requirement (Tr. 53-56; CX-6).

According to _________, this was the first time that he learned that the filing requirement applied to $5,000 broker-dealers (Tr. 31-32). _______ stipulated that he did not open the notices from the NASD until September 24, 1998 (Joint Stip. ¶ 10), explaining that "I'm not very well organized in general" and that his attention to other professional activities and to his mother's illness (which took him out of town for 8 to 10 days during August and September) caused the mail to pile up (Tr. 41, 45). _______ further testified that the NASD employee told him that the filing deadline was September 28 (Tr. 32, 49, 59), but admitted that he "may have misheard it" (Tr. 49).

After the September 17 telephone call, _______ said that he flew immediately to California on a business trip, and returned on September 24. When he opened his mail and realized that the deadline was September 21, he sent the Form by overnight delivery to NASD and to the SEC (Tr. 33, 43).[2] The parties stipulated that on September 24, 1998, _______ sent the form to the Association and the Commission by overnight delivery (Joint Stip. ¶11).

[2] _______ later testified that he did not remember the date of the California trip, and that it may have occurred a day or two after the September 17 telephone call (Tr. 53, 59).

III. Discussion

A. Liability

It is undisputed that Respondent ______________ was required to file its Form BD-Y2K by August 31, 1998 and did not do so until September 25, 1998. SEC Rule 17a-5(e)(5) required that the Form be filed "[n]o later than August 31, 1998." Respondent's failure to make such a filing plainly violated that Rule, as well as NASD Conduct Rule 2110. See, e. g., William H. Gerhauser, Exchange Act Rel. No. 40639, 1998 SEC LEXIS 2402 at *20 (November 4, 1998) (violation of an SEC Rule is itself a departure from "just and equitable principles of trade").

_______ attempted to explain the lateness by focusing on a September 17, 1998 telephone call from an NASD employee, where he believed that the employee mentioned September 28, 1998 as the filing deadline. Operating under that assumption, _______ went on a business trip and turned to the BD Y2K on September 24, after returning. He then saw that the grace period had expired on September 21 and immediately filled out the Form and sent it by overnight delivery and FAX to NASD and to SEC (Tr. 32, 46-47).

Proceeding from _______ testimony, Respondent's counsel argued that "this case should be judged on his state of mind" - i.e. he acted within the time he thought he had and then acted promptly thereafter, upon discovering that the deadline had passed (Tr. 72-73). In the Panel's view, _______ state of mind is not a defense to the violations charged. Neither the SEC Rule nor the NASD Rule contains words such as "knowingly," "intentionally," "willfully," or "fraudulently" - which would suggest the significance of state of mind. Moreover, as the Commission explained in Gerhauser, supra at *20:

> We have consistently maintained that a violation of another SEC rule … constitutes a violation of the requirement to adhere to "just and equitable principles of trade" embodied in the NASD Rules of Fair Practice … and does not require a finding of intent or scienter (<u>Gerhauser</u>, <u>supra</u>. at *20).

<u>See</u> <u>also</u> <u>District Business Conduct Committee v. L. H. Alton & Co.</u>, 1997 NASD Discip. LEXIS 60 (NBCC, December 17, 1997) (net capital violation, where intent was irrelevant, "necessarily" produced liability for inaccurate FOCUS Report (<u>Id</u>., at *11).

The Form BD Y2K, due on August 31, 1998, did not arrive until September 25, 1998. An asserted good faith belief in a different deadline cannot change those facts. In any event, _______ "honest intent" defense lacks merit. As the firm's sole principal and employee, he was responsible for complying with SEC regulations and NASD requirements. If _________ had simply opened and read any one of the four communications from NASD, which made clear that the deadline was August 31, 1998 (CX-1 through CX-4), there would have been no need to rely on his version of a telephone conversation, which he acknowledged he "may have misheard" because he was later diagnosed as "slightly hard of hearing" (Tr. 32, 49).

That _______ gets a "huge amount" of mail from NASD, ninety-five percent of which is irrelevant to his work (Tr. 38), does not justify ignoring four separate mailings over a two-month period, or "probably" allowing the Association's mail to pile up in a "big stack" (Tr. 41). This is especially so, considering that the September 11, 1998 letter came to him by express mail, a method which he admitted did not frequently occur in NASD mailings (Tr. 40).

Member firms and their principals are responsible for knowing the rules and regulations under which they operate.[3] Moreover, _______ is a well-educated person, with many years of experience in the legal profession, including substantial experience in securities law.[4] _______, licensed in the securities industry since 1985 (Tr. 26-27), should have known that the NASD mailings convey vital information to firms and individuals in the industry.

Here, as in District Business Conduct Committee v. Clinger & Company, 1993 NASD Discip LEXIS 224 at *8 (NBCC, April 22, 1993), aff'd, Exchange Act Rel. No. 33375, 1993 SEC LEXIS 3524 (December 23, 1993), _______ "exhibited indifference regarding his responsibility timely to file the firm's financial reports." The Panel concludes that Respondent (through _______) violated SEC Rule 17a-5(e)(5) and NASD Rule 2110 by failing to file the Form BD Y2K on time.

B. Sanctions

The NASD Sanctions Guidelines (1998) do not specifically mention untimely filings of Form BD Y2K. In those circumstances, adjudicators "are encouraged to look to

[3] See e.g. Jeffrey D. Field, Exchange Act Rel. No. 33952, 1994 SEC LEXIS 1169 (1994)("Fields was required properly to inform himself of the requirement associated with performing his function. As we have previously stated, '[P]articipants in the industry must take responsibility for their compliance [with applicable regulatory requirements] and cannot be excused for lack of knowledge, understanding or appreciation of these requirements' " (at *20; citations omitted).

[4] _______ attended and graduated from Yale University and Harvard Law School. Upon graduation from Harvard Law School, _______ passed the New York State Bar Examination and worked for New York firms, including six years with Sullivan & Cromwell. He then joined Merrill Lynch, where he worked as investment banking counsel, manager of the Tokyo Corporate Finance Office, and head of U.S. leverage lease financing. While at Merrill Lynch, _______ also became a managing director and "was in charge of municipal finance in the southern states." _______ then moved on to Salomon Brothers, where he worked for five years and ultimately became head of the Pension Services Group. In February 1994, _______ formed ______________ to "help small companies raise capital through private placements" (Tr. 21-24).

the guidelines for analogous violations" (Id., at 2). In this case, Enforcement properly turned to the recommendations for the analogous violation of untimely filed FOCUS reports, which, like Form BD-Y2K, are also required by SEC Rule 17a-5.

For that offense, the Guidelines recommend the "[n]umber of days late" as a principal consideration (Id. at 64). In the instant case, Respondent's form did not arrive until September 25, 1998 (Joint Stip. ¶ 11), twenty-five days after the August 31, 1998 deadline. Following the analogy, Enforcement sought a fine of $2,500, reflecting $100 per day for every day that the Form BD-Y2K was late (Tr. 12-13).

Respondent's counsel argued that because _________ believed that he was on time and acted promptly upon discovering the error, a sanction would not "raise the conscience" of _______ or of the self-regulated community (Tr. 70-74). This contention is not persuasive.

The Panel has discussed _______ indifference to four NASD mailings which laid out the correct deadline. To find liability, but impose no sanction because _______ was proceeding under some other notion, would excuse him for having ignored his self-regulatory organization's mailings, while rewarding his subjective and erroneous understanding of a particular deadline. Members and principals must realize that a meaningful self-regulatory organization cannot function that way. The Panel declines to treat the unopened mail and likely misheard telephone conversation as mitigating circumstances.

_________ explained that his elderly mother's illness caused him to be out of town for a time. This may well have been a distraction. But the absence was only for eight to ten days during August and September, a two-month period during which _______ admittedly spent at least sixty percent of his time working on investment business in his firm's office in New York

(Tr. 28-29, 37). Nor was Form BD Y2K particularly onerous; _______ testified that that it took him between one and one and a half-hours to complete. (Tr. at 50).

The argument that Enforcement's recommended fine of $2,500 is too high because it is "half this firm's regulatory capital" (Tr. 70) is also not persuasive as a matter in mitigation. There is no required disciplinary linkage between the level of fines and a firm's required net capital. Nor did _______ assert a bona fide inability to pay the $2,500. Moreover, a $2,500 fine is at the low end of the Guidelines-recommended range of $1,000 to $20,000 for late filing of FOCUS Reports (Guidelines, supra, p. 64).

Finally, Respondent's counsel argued, in the alternative, that the Panel should impose a $300 fine, reflecting three days of lateness, measured from the grace period deadline (Tr. 70, 74). The Panel disagrees with this approach. The Rule which the firm violated, SEC Rule 17a-5(e)(5), required the filing "[n]o later than August 31, 1998." The September date was simply an act of discretionary grace, which conferred no rights on Respondent. The Panel finds that the appropriate sanctions are a censure and a fine of $2,500. In addition, Respondent must pay costs of $1,069.95.

IV. Conclusion

Respondent failed to file the Form BD-Y2K in a timely manner as alleged in the Complaint. This act constituted a violation of Section 17(a) of the Securities Exchange Act of 1934, Rule 17a-5 thereunder, and NASD Conduct Rule 2110.

Respondent is censured and fined $2,500. In addition, Respondent is ordered to pay costs of $1,069.95, which include an administrative fee of $750 and the hearing transcript cost of $319.95.[5]

HEARING PANEL

BY: Jerome Nelson
Hearing Officer

Dated: Washington, D.C.
May 6, 1999

[5] The hearing panel 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.