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NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. RESPONDENT Respondent.	Disciplinary Proceeding No. C01020022 **Hearing Panel Decision** Hearing Officer – SW Dated: July 16, 2004

Enforcement failed to prove by a preponderance of the evidence that Respondent violated NASD Conduct Rule 2110 and NASD Membership and Registration Rule 1120 by being responsible for the following alleged violations of Mr. Stock, Inc. (n/k/a SK, LLC): (i) SEC Rules 17a-3 and 17a-4; (ii) SEC Rule 15c3-3; and (iii) NASD Membership and Registration Rule 1120 and NASD Conduct Rule 2110. The Hearing Panel dismissed the Complaint as to Respondent.

Appearances

David A. Watson, Esq., Regional Counsel, for the Department of Enforcement.

MK, Esq., Washington, DC, SK, Esq., and SB, Esq., San Francisco, California, for Respondent.

DECISION

I. Introduction

A. Complaint and Answer

On December 6, 2002, the Department of Enforcement ("Enforcement") filed a four count complaint in this disciplinary proceeding, naming five Respondents: (i) SK; (ii) Respondent; (iii) MF; (iv) FP; and (v) MH. Each of the Respondents, except

Respondent, executed a settlement offer that was accepted by NASD.[1] The allegations of counts one, two, and three of the Complaint involve Respondent.

Count one of the Complaint relates to SK's alleged failure to comply with the books and records requirements of SEC Rules 17a-3 and 17a-4 between March 1, 2000 and June 30, 2000. Count two of the Complaint relates to SK's alleged failure to comply with the customer protection requirements of SEC Rule 15c3-3 between August 21, 2000 and October 20, 2000. Count three of the Complaint relates to SK's alleged failure, between August 16, 1999 and August 24, 2000, to comply with the requirements of NASD Membership and Registration Rule 1120 that a firm prohibit a person from acting as a registered individual while his registration is inactive.

In response to the allegations of the Complaint, Respondent argued that, after February 2000, he was neither the FINOP nor the chief financial officer for SK, and no longer acted on behalf of SK, and therefore he was not responsible for SK's alleged failures in counts one and two of the Complaint. In addition, with respect to count two of the Complaint, Respondent further argued that SK was in compliance with the customer protection requirements of SEC Rule 15c3-3. With respect to count three of the Complaint, Respondent argued that he was not responsible for the Firm's monitoring of registration requirements after May 1999.

B. Hearing

The Parties presented evidence to a Hearing Panel in San Francisco.[2] The

[1] MH's accepted settlement offer was filed with the Office of Hearing Officers on June 20, 2003. The accepted settlement offers of SK, MF, and FP were filed with the Officer of Hearing Officers on December 23, 2003.

[2] References to the testimony set forth in the transcript of the Hearing on October 29, 2003 will be designated as "Tr. p.," and testimony from the October 30, 2003 Hearing transcript will be designated as "II Tr. p.," with the appropriate page number. References to the exhibits provided by Enforcement will be

Hearing Panel consisted of two current members of the District 1 Committee and the Hearing Officer. The Hearing Panel finds that Enforcement failed to meet its burden of showing by a preponderance of the evidence that Respondent was responsible for the Firm's alleged violations. Accordingly, the Hearing Panel dismisses the allegations in the Complaint against Respondent.

II. Discussion

A. Jurisdiction

Respondent was registered as a FINOP with SK from June 28, 1993 to August 21, 2001. (CX-8, p. 2). NASD has jurisdiction over Respondent pursuant to Article V, Section 4 of the NASD By-Laws. Enforcement filed the Complaint on December 6, 2002, within two years of the termination of Respondent's registration on August 21, 2001, and the charges in the Complaint arise from Respondent's alleged conduct while registered.

B. Findings of Fact and Conclusions of Law

1. Background

SK was formed in 1993, primarily to provide stock execution services for an affiliated company, GO Trading, L.P.[3] ("GO"). (II Tr. p. 13). In 1993, Respondent was the chief financial officer, the compliance officer, and the FINOP of SK, and he was the chief financial officer of GO.[4] (II Tr. pp. 8, 19-20). Respondent provided his services

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designated as "CX-," and references to the exhibits provided by Respondent will be designated as "RX-RG-."

[3] GO is an SEC registered, non-NASD member, broker-dealer that acts as a market maker/specialist, buying, selling, and dealing as a principal in U.S. exchange-traded securities and derivative financial instruments for its own account. (RX-RG-55, p. 6).

[4] Respondent began working at GO in 1991 as the finance manager. (II Tr. p. 6). In 1992, Respondent became chief financial officer and held that position until April 2003 when he became co-chief executive officer of GO. (II Tr. pp. 7-8).

to SK in exchange for a fee paid to GO, initially pursuant to an oral agreement, and then a written management fee agreement dated January 7, 1998.[5] (II Tr. p. 16; RX-RG-43).

In March 1999, SK, a relatively small broker-dealer, filed an application with NASD for approval to clear trades on an omnibus basis.[6] (II Tr. pp. 13, 22-24). Respondent prepared the application and as part of the application indicated that he would be hiring a new compliance director and controller.[7] (RX-RG-12, pp. 5, 7).

Respondent hired FP in April 1999 to be the director of compliance. (II Tr. pp. 37-38). FP's duties included preparing the necessary registrations and notifications to NASD. (II Tr. p. 38).

SK hired MF to undertake the FINOP responsibilities for the Firm.[8] (Tr. p. 141). MF had experience as the FINOP of a self-clearing broker and had participated in the development of an SEC Rule 15c3-3 reporting system for his previous employer. (II Tr. p. 34). Respondent had no experience as a FINOP of a self-clearing broker. (II Tr. p. 52). On July 16, 1999, Respondent wrote the NASD

[5] Initially, SK paid GO $2,250 a month for Respondent's services. (RX-RG-44, p. 1).

[6] For the year ended December 31, 1998, and the eleven months ended November 30, 1999, SK derived 75% of its revenue from execution services to non-affiliates, and 12% of its revenues from execution services to GO. (RX-RG-42, p. 16).

[7] The fee amount payable to GO for Respondent's services began to increase in October 1998, and peaked at $8,000 in May, June, and July 1999. (RX-RG-44, p. 1).

[8] MF was associated with the Firm from August 1999 to December 31, 2001. (CX-9, p. 2).

staff that SK had hired MF as its controller, explaining that MF was licensed as a FINOP and had experience preparing regulatory reports, weekly SEC Rule 15c3-3 computations, and other financial reporting. (RX-RG-38). MF actually began working at SK in August 1999. (Tr. p. 240; II Tr. p. 89). Although a Form U-4 was filed to register MF as a FINOP on November 30, 1999, MF was not approved as a registered FINOP for the Firm until August 25, 2000. (CX-9, p. 2; RX-RG-33, pp. 1-2).

As SK worked towards commencing omnibus clearing operations, it became apparent that it would be difficult for Respondent to continue in his then current roles for both GO and SK. (II Tr. p. 78). GO was about to commence a big system expansion and was rapidly growing, and SK was rapidly growing as well.[9] (Id.). At the end of 1999, Respondent orally notified Mr. Van Der Wal of NASD that MF would be taking over his FINOP duties at the Firm. (II Tr. p. 83).

On January 19, 2000, MF received his first regulatory inquiry from NASD. (RX-RG-47). Beginning January 31, 2000, MF filed the Firm's FOCUS reports, and the NASD staff contacted MF if they had any questions.[10] (RX-RG-62; Tr. p. 117).

[9] SK spent January 1999 to October 1999 developing a proprietary comprehensive on line stock and option trading system. (RX-RG-42, p. 16).

[10] MF filed the FOCUS Reports for the Firm from January through November 2000. (RX-RG-15; RX-RG-62; RX-RG-63; RX-RG-64; RX-RG-65; RX-RG-66; RX-RG-67; RX-RG-68; RX-RG-69; RX-RG-70; RX-RG-71).

After January 2000, Respondent continued to consult with MF, but only in his capacity as chief financial officer of GO.[11] (II Tr. p. 76). By February 2, 2000, when SK converted from an introducing broker to an omnibus clearing broker, Respondent made the decision to move to GO's New York office and to terminate all of his positions with SK. (Tr. p. 249; RX-RG-46). Respondent notified the appropriate individuals, including FP. (II Tr. pp. 48, 85). The Firm interviewed a person for the position of chief financial officer of SK, but the position remained unfilled as of July 2000. (RX-RG-4, p. 1; Tr. p. 149).

In August 2000, the NASD staff notified FP, as the Firm's Director of Compliance, that SK would be audited, and FP notified each of the department heads of the Firm of the impending audit. (RX-RG-50; Tr. p. 43). FP did not include Respondent on his notification to the department heads. (RX-RG-50). On August 16, 2000, in preparation for the NASD audit, FP submitted on behalf of SK a member questionnaire to NASD that identified MF as the contact person for financial reporting. (RX-RG-9, pp. 2, 7).

The NASD staff advised FP that MF could not be the FINOP of the Firm because MF had failed to fulfill his continuing education obligations.[12] (Tr. p. 44). FP orally advised the NASD staff that there was not a problem because Respondent remained SK's FINOP. (Tr. pp. 45, 200).

However, as represented by the exit conference summary report prepared by the NASD staff on September 5, 2000, SK's personnel continued to refer to MF as the Firm's

[11] The management fee payable to GO by SK for Respondent Respondent's services declined to $2,500 by January 2000, and remained at $2,500 until Respondent relocated to New York in mid May 2000 when it was reduced to zero. (RX-RG-44, p. 1).

[12] MF's registration was deemed inactive from June 19, 1999 to August 24, 2000. (Tr. p. 63; CX-9, p. 3).

FINOP at the NASD audit, and referred questions regarding the Firm's financial reporting to MF. (RX-RG-6, pp. 2, 6).

In responding to the NASD's exit report, Mr. S, the president of SK, did not represent that Respondent was the Firm's FINOP, rather he wrote that it was not necessary for MF to be registered because he did not have direct customer contact.[13] (RX-RG-7, p. 4). Despite FP's representation to the NASD staff that Respondent was the Firm's FINOP, the Firm did not mention Respondent when responding to comments regarding the Firm's FINOP. (RX-RG-7, p. 3; Tr. p. 45). In addition, the Firm's response was not copied to Respondent, nor did Respondent participate in drafting the Firm's response. (Tr. pp. 180-181; RX-RG-7, p. 5).

In response to the NASD staff's audit request, SK, on September 5, 2000, provided a list of the Firm's supervisors, which listed MF as the designated supervisor for the Accounting Department as of August 1999.[14] (RX-RG-6, pp. 1-2; RX-RG-8, p. 2). The list of supervisors did not include Respondent. (RX-RG-8, p. 2). Respondent was not listed as a SK supervisor, the Firm's FINOP, or the Firm's chief financial officer. (Id.). The September 5, 2000 list of supervisors was not consistent with FP's earlier representation to the NASD staff that an August 2000 list of registered personnel for SK, printed from NASD's IRIS computer system, could

[13] The Firm's audit response also consistently referred to MF as correcting the errors found in the Firm's financial report. (RX-RG-7, pp. 2-3).

[14] In its audit letter, the NASD staff noted that SK's January 2000 written supervisory procedures "did not include a designation of principal for each business type; assignment of registered persons; supervisory personnel record including title, registration status, and location." (RX-RG-6, pp. 1-2).

be used as the designation of supervisors for SK's January 2000 written supervisory procedures. (Tr. pp. 90-92; CX-14, pp. 118-122). The August 2000 list included Respondent. (CX-14, pp. 118-122).

The Hearing Panel finds that MF, SK, and Respondent each acted under the assumption that MF had the qualifications to be SK's FINOP, and that MF, as of January 2000, was performing FINOP duties as described in NASD Membership and Registration Rule 1022(b)(2).

2. Cause One of the Complaint: Books and Records Violations Not Proven

Cause one of the Complaint alleges that, from March 1, 2000 through June 30, 2000, Respondent violated NASD Conduct Rule 2110 when SK, acting through Respondent and MF, failed to make and preserve books and records relating to: (a) short stock dividends and distributions; (b) short securities differences; (c) suspense accounts; (d) short securities with related credit balances; (e) unclaimed dividends and interest payable; (f) unconfirmed transfers; (g) securities failed to receive and failed to deliver; (h) net capital charge for margin calls over 5 days; (i) reconciliation of inventory positions; (j) Regulation T extension filings; and (k) accounts subject to a 90 day freeze, in violation of SEC Rules 17a-3 and 17a-4 and NASD Conduct Rule 2110.

SEC Rule 17a-3(a) provides that every broker or dealer shall make and keep current certain books and records including, among other things, a ledger reflecting (i) securities in transfer, (ii) dividends and interest received, and (iii) securities failed to receive and failed to deliver. SEC Rule 17a-4 provides that every broker or dealer shall preserve the books and records created pursuant to SEC Rule 17a-3 for a specified period of time, e.g., six years for certain records and two years for certain other records.

NASD Membership and Registration Rule 1022(b) provides that every broker-dealer shall designate as FINOP those persons, at least one of whom shall be its chief financial officer, who perform certain duties, including: (i) supervision and responsibility for individuals who are involved in the actual maintenance of the member's books and records; (ii) final approval and responsibility for the accuracy for the financial reports submitted to any securities industry regulatory body; and (iii) supervision and/or performance of the member's responsibility under all the financial responsibility rules promulgated under the Exchange Act.

Enforcement argued that the NASD staff was entitled to hold Respondent responsible for SK's actions because Respondent was the Firm's chief financial officer and was registered as the Firm's only official FINOP during the relevant period. The Hearing Panel finds that, no later than February 2000, Respondent relinquished his title of chief financial officer of SK. Generally, the Hearing Panel would agree that when an individual accepts the title of FINOP, he is responsible for performing the duties of the FINOP.[15]

Respondent testified that he believed that he effectively transferred his FINOP duties to MF in January 2000 because: (1) he orally advised NASD that MF would be the FINOP; (2) he advised FP that MF was the FINOP for the Firm; (3) he knew that the NASD staff contacted MF beginning in 2000 when it had financial questions regarding the Firm; (4) MF signed the FOCUS reports beginning in 2000;[16] (5) he did not have a

[15] See Gilad J. Gevaryahu, 51 SEC 710 (1993) (once a person agrees to serve as a firm's FINOP, and for so long as he retains that position, he is responsible for carrying out its attendant duties and obligations). See also George Lockwood Freeland, 51 SEC 389 (1993).

[16] In addition, on March 24, 2000, MF, in his role as the Firm's FINOP, notified NASD of a change in the method by which the Firm would calculate its net capital requirements. (RX-RG-48). MF also signed the affirmation for SK's December 31, 2000 annual report. (RX-RG-11).

SK compliance review for 2000; (6) he did not participate in SK's senior management conference calls after February 2000; (7) he did not participate in the strategic planning meeting for SK after February 2000; (8) SK no longer made payments to GO for his services as of April 2000; (9) he did not receive stock options for 2000 from SK; and (10) he did not have access to the Firm's computer system after moving to New York. (II Tr. pp. 105-106). Based on the consistency of his testimony with the written documents and the internal consistency of his testimony, the Hearing Panel finds Respondent to be a credible witness.

Enforcement argued that Respondent's written direction to SK to terminate his FINOP status on August 21, 2001, more than a year after the audit, indicated that he had not relinquished his FINOP responsibilities or his responsibilities as the chief financial officer prior to August 21, 2001. The Hearing Panel is not persuaded.

The Hearing Panel finds that, in this case, Respondent clearly relinquished his responsibilities as SK's FINOP to MF during the period after January 2000,[17] and he took reasonable steps to notify all parties that he had also relinquished the title of FINOP. Respondent had also relinquished his position as chief financial officer, as revealed by the Firm's internal directory and organizational chart. (RX-RG-2, RX-RG-4, p. 1). FP neglected to follow up on the appropriate filings to notify NASD that MF was the Firm's designated FINOP. (RX-RG-1, p. 27). FP also failed to file the appropriate papers to indicate that Respondent was no longer the chief financial officer or performing any of the designated duties of a FINOP. The Hearing Panel finds that it was reasonable for Respondent to rely on the compliance director to complete any necessary paperwork.

[17] MF testified that he did not find out that he was not registered as a FINOP until the NASD audit of SK in August 2000. (Tr. p. 241). Mr. S testified that he was surprised when he learned at the NASD audit that

Because the Hearing Panel finds that during the relevant period: (i) Respondent was not SK's chief financial officer; (ii) Respondent was not performing the duties of a FINOP for SK; (iii) MF was performing the duties of a FINOP for SK; and (iv) NASD was aware that MF was performing the duties of the FINOP for SK, the Hearing Panel finds that Respondent was not acting on behalf of SK during the relevant period, March 1, 2000 through June 30, 2000. The Hearing Panel notes that, in some instances, equity dictates that substance rather than form should control.

In any event, Enforcement failed to provide evidence at the Hearing that SK failed to create and preserve required books and records. Mr. Grasso, an NASD supervisor, testified that when he asked MF for the listed records, MF said the Firm did not have them. (Tr. pp. 41, 98-99). However, Enforcement failed to present any evidence that the particular records were required to be created because of SK's activities. For example, there was no evidence presented at the Hearing that the Firm had (i) unclaimed dividends and interest payable, (ii) margin calls over 5 days, (iii) Regulation T extensions, or (iv) accounts subject to a 90 day freeze.

Accordingly, the Hearing Panel finds that Enforcement failed to meet its burden of proving by a preponderance of the evidence the allegations of count one of the Complaint as they relate to Respondent. Count one of the Complaint is hereby dismissed as to Respondent.

3. Cause Two of the Complaint: Customer Protection Violation of SEC Rule 15c3-3 Not Proven

Cause two of the Complaint alleges that, from August 21, 2000 through October 20, 2000, Respondent violated NASD Conduct Rule 2110 when SK, acting through

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MF was not registered as the Firm's FINOP. (Tr. p. 127).

Respondent and MF, failed to maintain control of customer securities, in violation of SEC Rule 15c3-3(b)(1). Specifically, the Complaint alleges that SK maintained its customers' securities in an omnibus account with Merrill Lynch Professional Clearing Corporation ("Merrill") and failed to instruct Merrill that the customers' fully paid securities and excess margin securities were to be maintained free of any charge, lien, or claim. Count two of the Complaint further alleges that SK failed to determine the quantity of the fully paid securities and excess margin securities on a daily basis and notify Merrill of those determinations via a segregation report, in violation of SEC Rules 15c3-3(c) and 15c3-3(d).

a. Omnibus Clearing Agreement

At the NASD audit, a question arose concerning the Firm's compliance with the customer protection requirements of SEC Rule 15c3-3. (RX-RG-6, pp. 2-3). SK had entered into an omnibus clearing agreement with Merrill on July 23, 1999. (CX-1). Previously, in connection with a proprietary account with Merrill, SK had executed a 1993 customer agreement with Merrill that provided that the securities and property of SK could be pledged and hypothecated by Merrill without notice to SK and without Merrill retaining in its possession or under its control for delivery a like amount of similar securities or other property. (Tr. pp. 70-72; CX-20, p. 1). Pursuant to the terms of the customer agreement for any indebtedness owed to Merrill by SK, there was a lien on securities owned by SK but held in the custody of Merrill.[18] (CX-20, p. 1).

MF, on behalf of the Firm, filed FOCUS Reports that indicated that the customers' securities held in the Firm's omnibus account were being held as collateral for

[18] Rule 15c3-3 requires broker-dealers to segregate all customers' fully paid and excess margin securities from securities that are being held as collateral on loans for which the broker dealer is the borrower.

a debt owed to Merrill by SK. (Tr. pp. 251-253; CX-4, p. 9; CX-2).

In response to questions by the NASD staff, Merrill wrote a letter to SK on August 30, 2000, which was copied to NASD, confirming that all securities carried long in the omnibus account for SK were considered fully paid or excess margin securities for purposes of SEC Rule 15c3-3. (RX-RG-52). Accordingly, if all the securities were customers' fully paid or excess margin securities, they were not collateral for SK's debt to Merrill.

In October 2000, SK made the decision to recalculate its SEC Rule 15c3-3 reserve amounts in its FOCUS reports to indicate that the customer securities in the omnibus account were not collateral for any debts owed to Merrill by SK.[19] (CX-6). In the October 20, 2000 FOCUS report, the line item entitled "Monies Borrowed Collateralized by Securities Carried for the Accounts of Customers" was reduced to zero to indicate that the securities held in the omnibus account did not collateralize any debt owed to Merrill by SK, although there remained a loan balance owing from SK to Merrill. (CX-7, p. 1; Tr. p. 254).

MF testified that he discussed the issue of how to record the loans with Respondent and that they both made the decision.[20] (Tr. p. 255). Respondent testified

[19] Rule 15c3-3 does permit broker-dealers to borrow customers' fully paid or excess margin securities but only if, among other things, the loan is fully collateralized with collateral that is deposited into a broker-dealer's special reserve bank account for the exclusive benefit of its customers. Generally, a broker-dealer must calculate any amounts it owes to its customers and the amount of funds generated through the use of customer securities, called credits, and compared this amount to any amounts its customers owe it, called debits. If customer credits exceed customer debits, the broker-dealer must deposit the net amount of customer credits in the special reserve account. In the Firm's October 6, 2000 reserve calculation, the "monies borrowed collateralized by securities carried for the accounts of customers" was $10,112,584. (CX-2, p. 1).

[20] August 30, 2000 e-mails from SK to Merrill indicated that the decision involved MH, the Firm's director of operations, and BD, the Firm's manager of client services. (RX-RG-53; RX-RG-2, pp. 1, 3). Count four of the Complaint alleges that from April 1, 2000 to March 16, 2001, MH exercised supervision over SK's back office, which is a position that requires registration as a FINOP, without being registered as a FINOP,

that he spoke with MF but that he suggested to MF that it was a legal matter and that MF should contact the Firm's outside counsel and outside auditors to make the decision. (II Tr. pp. 116-117).

b. Customer Protection Requirements

SEC Rule 15c3-3(b)(1) requires a broker or dealer to promptly obtain and thereafter maintain the physical possession or control of all fully paid securities[21] and excess margin securities[22] carried for the accounts of customers, i.e., the securities must be held in a good control location. Securities in an omnibus account are deemed securities in a good control location if the requirements set forth in SEC Rules 15c3-3(c) and (d) are met.

Specifically, Rule 15c3-3(c) provides, in part, that customer securities are considered to be in a good control location, when the securities are carried in a specific omnibus account in the name of such broker or dealer with another broker or dealer, to the extent that the broker or dealer has instructed such carrying broker or dealer to

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in violation of NASD Membership and Registration Rule 1022(b).

[21] SEC Rule 15c3-3(a)(3) defines fully paid securities to include all securities carried for the account of a customer in a special cash account.

[22] SEC Rule 15c3-3(a)(5) defines excess margin securities to include those securities having a loan value carried in a general account and having a market value in excess of 140% of the total debit balances in the customer's account.

maintain physical possession and control of them free of any charge, lien or claim of any kind in favor of such carrying broker.[23]

SEC Rule 15c3-3(d) requires a broker-dealer to determine the daily amount of customer fully paid securities and excess margin securities in its possession and control, and the amount of such securities not in its possession or control, using data as of the close of the business day. The purpose of these rules is to ensure that a broker-dealer does not place at risk assets belonging to its customers.

c. Good Control Location

Enforcement argued that because SK, through Respondent and MF, failed to provide Merrill with segregation reports setting forth the amount of fully paid securities and excess margin securities in SK's omnibus account, the securities in the account were not in a good control location and therefore not deemed in SK's physical possession or control as required by SEC Rule 15c3-3(b). Enforcement argued that by failing to create and deliver the segregation reports to Merrill, Merrill's 1993 lien created in connection with SK's original proprietary account might have been effective.

Although arguing that he was not the Firm's chief financial officer and did not make the decision that securities in SK's omnibus account should not be deemed

[23] SEC Rule 15c3-3(c)(2) provides that securities under the control of a broker of dealer are deemed to include securities which:

> [a]re carried for the account of any customer by a broker or dealer and are carried in a special omnibus account in the name of such broker or dealer with another broker or dealer in compliance with the requirements of Section 4(b) of Regulation T under the Act, such securities being deemed to be under the control of such broker or dealer to the extent that he has instructed such carrying broker or dealer to maintain physical possession or control of them free of any charge, lien, or claim of any kind in favor of such carrying broker or dealer or any persons claiming through such carrying broker or dealer.

to collateralize SK's loans from Merrill, Respondent also argued that because Merrill agreed that 100% of the securities in the omnibus account were to be treated as fully paid securities and excess margin securities, no segregation report was required to constitute the omnibus account as a good control location.

Mr. SL, who from 1986 to 2001 had the principal responsibility of interpreting SEC Rule 15c3-3 for NASD, testified that in his expert opinion the securities held in SK's omnibus account at Merrill were in a good control location, and, accordingly, SK had not violated SEC Rule 15c3-3(b).[24] (II Tr. pp. 168, 177). Mr. L testified that SK did not have to do a daily calculation as to which securities were excess margin securities and which ones were not excess margin securities or fully paid securities because all of the securities were to be treated as fully paid for and property of the customers of SK.[25] (II Tr. p. 180).

Mr. L further testified that the 1993 agreement did not create a lien on the omnibus account and did not change his opinion that the securities were in a good control location for purposes of SEC Rule 13c3-3.[26] (II Tr. p. 183). Enforcement did not present an expert to dispute Mr. L's testimony. Subsequently in 2001, Merrill and SK amended the omnibus agreement to grant Merrill a lien on the securities in the omnibus account and SK began providing segregation reports to Merrill.

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[24] Mr. L, who has testified as an expert witness in several NASD arbitration proceedings, and has provided consulting services in financial, operational, and compliance areas to securities brokers and dealers, testified as an expert witness in this proceeding. (II Tr. pp. 165-166). Mr. L has been in the securities industry for 39 years on both the industry side and the regulatory side. (II Tr. p. 166).

[25] Mr. L testified that "if all the securities belonging to customers were in [the firm's] physical possession or control, [the firm] did not have to do a daily calculation as to what securities were excess margin securities and which ones were not margin securities or fully paid for securities." (II Tr. p. 180).

[26] Because the customer securities in the omnibus account were deemed fully paid or excess margin securities, SK would not have been deemed as having an interest in the securities in the omnibus account. (II Tr. p. 191).

(II Tr. pp. 57-58).

In light of Mr. L's testimony, the Hearing Panel does not find that Enforcement met its burden of proving by a preponderance of the evidence that SK violated SEC Rule 15c3-3(b)(1).

In addition, the Hearing Panel finds Respondent's testimony that he did not make the decision regarding SK's omnibus account in August 2000 credible because his testimony was consistent with documents and his other testimony that he had ceased acting as a chief financial officer or FINOP for SK. Therefore, as discussed previously, the Hearing Panel does not find that SK was acting through Respondent during the relevant period.

Accordingly, the Hearing Panel hereby dismisses the allegations of count two of the Complaint as they relate to Respondent.

4. Count Three of the Complaint: Respondent Not Responsible for MF's Performing the Duties of a Registered Person while his Registration was Inactive

Count three of the Complaint alleges that, from August 16, 1999 to August 24, 2000, Respondent violated NASD Membership and Registration Rule 1120 and NASD Conduct Rules 2110 when SK, acting through Respondent and FP, permitted MF to perform the duties of a registered person while his registration was deemed inactive for failure to complete the regulatory element of the continuing education.

NASD Membership and Registration Rule 1120 provides that no member shall permit any registered person to continue to perform duties as a registered person unless such person has completed specific continuing education training prescribed by NASD. A person who has not completed the regulatory element within prescribed time frames

will have his registration deemed inactive until the requirements of the program have been completed. It is not disputed that MF performed the duties of a registered person between August 16, 1999 and August 24, 2000 while his registration was inactive.

The Firm's written supervisory procedures provided that the duty to monitor or ensure compliance with continuing education and to ensure that inactive employees did not act in a registered capacity was assigned to FP as the Director of Compliance.[27] (RX-RG-1, p. 27). FP admitted that those duties were assigned to him and performed by him after May 19, 1999.[28] (Tr. pp. 219-220). Mr. S, the president of SK, and Respondent testified that FP was responsible for monitoring MF's registration and compliance with continuing education. (Tr. p. 173).

Only FP testified that Respondent took control of the registration responsibilities for MF. (Tr. pp. 192-193). FP denied that HV, who signed MF's Form U-4, assisted him in preparing Form U-4s. (Tr. p. 222; RX-RG-33, pp. 1, 7). Ms. R, the former human resource director for SK, testified that Ms. V was FP's assistant. (II Tr. pp. 195, 202). Respondent testified that Ms. V originally worked as an administrative person in human resources and later assisted FP in Form U-4 filings and other administrative matters. (II Tr. pp. 45, 202). Ms. V signed as the appropriate signatory on the Form U-4s for at least nine individuals between November 1999 and January 2000, and even signed as the appropriate signatory on FP's Form U-4 amendment filed on March 9, 2000. (RX-36; RX-27; RX-28; RX-29; RX-30; RX-31; RX-32; RX-33; RX-34; RX-35).

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[27] Section 3.2.2.7 of the Firm's procedures provided that the Director of Compliance is responsible for follow up to ensure required firm element continuing education is completed. (RX-RG-1, p. 27). Section 3.2.3 of the Firm's procedures provided that [t]he Director of Compliance will notify affected persons and their supervisors by phone and written memorandum when their registration becomes inactive and when the requirement is satisfied and inactive status is lifted. (RX-RG-1, p. 28).

[28] FP signed as the appropriate signatory on the Form U-4s of: (i) BD on August 17, 1999; (ii) BG on

Because FP's testimony was inconsistent with certain documents and because FP was not immediately forthright about the reasons for his September 2000 termination by SK, the Hearing Panel did not find FP to be a credible witness.[29] (CX-18, p. 6). It is undisputed that Respondent first learned that MF was not properly registered during SK's August 2000 NASD audit. (II Tr. p. 51).

Accordingly, the Hearing Panel finds that Enforcement failed to meet its burden of proving by a preponderance of the evidence the allegations of count three of the Complaint as they relate to Respondent. Count three of the Complaint is hereby dismissed as to Respondent.

III. Conclusion

The Hearing Panel concludes that Enforcement has not established by a preponderance of the evidence that Respondent violated NASD Conduct Rule 2110 or NASD Membership and Registration Rule 1120 by permitting SK to violate: (i) SEC Rules 17a-3 and 17a-4; (ii) SEC Rule 15c3-3; and/or (iii) NASD Membership and Registration Rule 1120 and Conduct Rule 2110. Accordingly,

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August 18, 1999; and (iii) AD on September 22, 1999. (RX-RG-22; RX-RG-23; RX-RG-24).

[29] FP initially testified that he did not know why SK fired him. (Tr. p. 202). During cross examination, FP admitted that he failed to disclose to SK that in April 2000 he was criminally charged with brandishing a weapon and carrying a concealed weapon. (Tr. pp. 213-216). In September 2000, FP was tried on the criminal charges; FP also failed to disclose the trial to SK. (Id.).

the Complaint in this proceeding is dismissed in its entirety as to Respondent.[30]

HEARING PANEL

By: Sharon Witherspoon
Hearing Officer

Dated: Washington, DC
July 16, 2004

[30] The Hearing Panel has 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.