NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT, Complainant, v. NORTHWESTERN MUTUAL INVESTMENT SERVICES, LLC (CRD No. 2881), DIANE B. HORN (CRD No. 1974921), and Respondent 3, Respondents.	Disciplinary Proceeding No. C8A030071 Hearing Officer – SNB **HEARING PANEL DECISION**

Respondents failed to timely report 76 customer complaints in violation of Conduct Rules 2110 and 3070. Respondent Northwestern also (1) failed to supervise to prevent these reporting failures in violation of Conduct Rules 2110 and 3010; (2) failed to timely report settlements of two arbitrations in violation of Conduct Rules 2110 and 3070; and (3) failed to timely amend a Form U-5 to report these arbitration settlements in violation of Rule 2110. For the failure to timely report customer complaints, Respondent Northwestern is censured and fined $50,000; Respondent Horn is censured and fined $15,000; and Respondent 3 is censured and fined $5,000. Respondent Northwestern is also censured and fined $50,000 for the failure to supervise, censured and fined $5,000 for the failure to timely report arbitration settlements, and censured and fined $5,000 for the failure to timely amend Forms U-5 to reflect these settlements.

Appearances

Richard S. Schultz, Esq., and Pamela Shu, Esq., Chicago, IL (Rory C. Flynn, Esq., Washington, DC, of Counsel), for Complainant.

Steven M. Malina, Esq., Chicago, IL, for Respondent Northwestern Mutual Investment Services, LLC.

Ronald P. Kane, Esq., Chicago, IL, for Respondent Diane B. Horn.

Bruce Lewitas, Esq., Chicago, IL, for Respondent 3.

DECISION

I. Procedural History

On September 26, 2003, the Department of Enforcement filed a Complaint charging that Respondents Northwestern Mutual Investment Services, LLC ("Northwestern" or "the Firm"), Diane B. Horn ("Horn") and Respondent 3 failed to timely report customer complaints in violation of Conduct Rules 2110 and 3070; and Respondent Northwestern: (1) failed to supervise timely reporting of customer complaints in violation of Conduct Rules 2110 and 3010; (2) failed to report settlements of two arbitrations within 10 business days in violation of Conduct Rules 2110 and 3070; and (3) failed to timely amend the registered representative's Form U-5 to report a settlement of these customer complaints in violation of Rule 2110. The Respondents filed Answers denying the charges and requesting a hearing, which was held in Chicago, Illinois on October 27 and 28, 2004, and December 21, 2004, before a Hearing Panel that included a Hearing Officer, one former member of the District Eight Committee, and one current member of the District Four Committee.[1] The Department of Enforcement called three NASD staff members as witnesses. Respondent Horn and Respondent 3 testified on their own behalf, and called Lora A. Rosenbaum, former Vice President of Compliance Best Practices at Northwestern.

II. <u>The Respondents</u>

A. Northwestern

During all times relevant to this proceeding, Northwestern was a registered broker/dealer and member of NASD. Northwestern's registration with NASD is currently in effect.[2] Northwestern is affiliated with The Northwestern Mutual Life Insurance Company.

B. Horn

Horn has been in the securities industry since 1984. She has been registered with Northwestern as a General Securities Representative and Investment Company and Variable Contracts Products Principal since June 7, 2000, and as a General Securities Principal since February 27, 2001. Horn has served as the Chief Compliance Officer of Northwestern since June 21, 2000, and has no prior disciplinary history.[3]

C. Respondent 3

Respondent 3 has been in the securities industry since 1995. He has been registered as a General Securities Representative and General Securities Principal with Northwestern since April 2, 1999. From April 1999 to approximately May 2000, Respondent 3 was the Assistant Director of Equity Compliance reporting to the Vice President of Compliance Best Practices for Northwestern

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[1] Enforcement offered Complainant's Exhibits ("CX") 1-24 and 26, which were admitted without objection. Northwestern, Respondent 3, and Horn each offered one exhibit, all of which were admitted without objection. Citations to the Hearing transcript are cited as "Tr.".

[2] Stip. at ¶ 1.

[3] Stip. at ¶ 2; CX-2; Tr. at p. 334, 344 (Horn).

Mutual Life Insurance Company. During this time, Respondent 3 served as the Chief Compliance Officer of Northwestern. From May 2000 through October 31, 2001, Respondent 3 continued to work as Assistant Director of Equity Compliance, but no longer served as Northwestern's Chief Compliance Officer. During this time, he reported to Horn. After November 1, 2001, Respondent 3 no longer worked in the Compliance Department. Respondent 3 has no prior disciplinary history.[4]

III. Facts

A. Customer Complaint Reporting

The facts are largely undisputed. From May 6, 1999, to February 27, 2001, Northwestern received at least 76 customer complaints that it did not timely report to NASD.[5] Northwestern first became aware of this issue in July 2000, when a member of Respondent 3's staff informed him of a customer complaint that had not been timely reported. Apparently, the department that received the complaint did not forward it to the Equity Compliance Department until the receiving department completed its investigation of the complaint.[6] Respondent 3 reminded that department that the Firm's policy required complaints to be immediately forwarded to the Equity Compliance Department and told his staff member to be alert for a wider problem and bring any further issues to his immediate attention.[7]

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[4] Stip. at ¶ 3; CX-3; Tr. at p. 537, 539 (Respondent 3).

[5] CX-15 at 3-7; CX-5 at 156-73; CX-4. The Complaint alleges that Respondents failed to timely report 80 customer complaints. At the hearing, Respondents stipulated that 73 of these 80 complaints were correctly characterized as customer complaints that Northwestern was required to report. Tr. 421-422, 595; CX-4. Although Respondent 3 testified that the seven remaining complaints in dispute should have been reported (Tr. 576-598), Northwestern argued in its Post Hearing Brief that four of the remaining complaints were not reportable under Rule 3070(c). Northwestern Post Hearing Brief at 13. Because the Hearing Panel finds that the difference between 76 and 80 untimely reported complaints is immaterial for purposes of this decision, the Panel found it unnecessary to determine whether Northwestern was required to report those remaining four complaints.

[6] Tr. at p. 540, 541 (Respondent 3).

[7] Id.

Because the Complaint involved a U-4 reportable event, Respondent 3 filed the required Form U-4 amendment for the registered representative referenced in the complaint.[8] In response, NASD Special Investigator Eugenia Sampat ("Sampat") contacted Respondent 3 to inquire about the late filing. Respondent 3 explained the circumstances and told Sampat that Northwestern would "keep an eye on the problem." He said he would contact her again if there was anything further.[9] Respondent 3 also advised Horn, his supervisor, of the situation.[10]

Approximately one month later, in August 2000, Respondent 3 was alerted to a second unreported complaint from a different department.[11] He directed his staff to request that the Firm's Market Conduct Department conduct an audit of complaints, in order to determine the extent of the problem. The Market Conduct Department was "backed-up" and could not get to it, so Respondent 3 requested the files and personally undertook a review.[12] He continued to keep Horn informed of the situation as it developed.[13]

Over the next several months, from approximately August through October 2000, Respondent 3 proceeded to review 25 boxes of complaint correspondence, ultimately identifying many additional unreported complaints.[14] This review was completed in October 2000, when Respondent 3 identified approximately 80 unreported complaints.[15] Respondent 3 concluded that Northwestern's deficiencies with respect to the reporting of complaints were generally due to

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[8] Tr. at p. 541 (Respondent 3).

[9] Tr. at p. 541 (Respondent 3).

[10] Tr. at p. 360 (Horn).

[11] Tr. at p. 541-542 (Respondent 3).

[12] Tr. at p. 541-543 (Respondent 3).

[13] Tr. at p. 360 (Horn).

[14] Tr. at p. 543-546 (Respondent 3); Tr. at p. 363 (Horn); Northwestern Exhibit 1.

[15] Tr. at p. 452, 455 (Horn).

failures to properly route complaints to Northwestern's Equity Compliance Department. A number of Northwestern's unreported complaints were apparently mishandled in the mailroom at Northwestern's headquarters. However, Northwestern also did not properly route complaints received by the Chief Executive Officer's office and the Compliance Best Practices Department of Northwestern Mutual Life Insurance Company.[16]

Respondent 3 and Horn believed that they could not resolve the late reporting issue until they identified, and addressed, if necessary, any patterns of wrongdoing reflected in the complaints, and developed new complaint reporting procedures for reporting them.[17] Accordingly, Respondent 3 and Horn did not discuss how to approach the late reporting issue until October 2000. At that time, Respondent 3 expressed his concern that if Northwestern reported the complaints to NASD at one time, the spike in the number of reported complaints would raise an unwarranted red flag to NASD. Respondent 3 believed that NASD's reporting mechanism showed only the date complaints were reported to NASD, not the date the Firm received the customer complaint. (In fact, however, NASD's form for summarizing customer complaints specifically asks for the date of the complaint.)[18] Respondent 3 suggested to Horn that they wait and seek guidance from the NASD staff during Northwestern's next examination.[19] Although the examination was not scheduled, Respondent 3, a former NASD examiner who did Northwestern's 1992 inspection, made an educated guess that NASD's field inspection for the examination would occur within the next few

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[16] Tr. at p. 606-619 (Respondent 3); Tr. at 404-405 (Horn).

[17] Horn and Respondent 3 took steps to assure themselves that the complaints were appropriately handled within Northwestern and did not indicate a pattern of wrongdoing by any Northwestern employees that needed to be addressed. Tr. at p. 361-365, 370 (Horn); Tr. at p. 547-549 (Respondent 3). They also took measures to develop new procedures and train Northwestern's field staff on proper reporting of customer complaints to avoid a recurrence. Id.; Tr. at p. 93; CX-12. The parties stipulated at the hearing that following January 1, 2001, Northwestern adopted extensive written procedures with respect to reporting customer complaints. Tr. at p. 147-148.

[18] Tr. at p. 170-71 (Tonyan); CX-10 at 11.

months, in early 2001.[20] Horn agreed with Respondent 3's suggestion, and Northwestern declined to report the complaints at that time.[21]

In October 2000, Horn and Respondent 3 met twice with Horn's superior, Lora Rosenbaum, Vice President of Compliance Best Practices, and two lawyers from the Firm's office of general counsel, to discuss their strategy for dealing with the unreported customer complaints.[22] At the time of this meeting, Respondent 3's review of the complaints was complete or almost complete.[23] Horn and Respondent 3 were unable to testify about the substance of these meetings at the hearing because Northwestern asserted the attorney-client privilege. However, the evidence did establish that the Firm decided to wait until NASD's examination to disclose the unreported complaints.[24]

In late October or early November 2000, at Horn's suggestion, Respondent 3 contacted Sampat and informed her that he was conducting an audit and had found "a few" complaints that Northwestern had not reported, although it is unclear whether this occurred before or after the meetings with Rosenbaum referenced above. Respondent 3 told Sampat that there might be more and that she "may or may not see a spike in the Firm's complaint reporting."[25] Respondent 3 did not ask Sampat for guidance on how the complaints should be reported.[26] Sampat took notes of this

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[19] CX-16 at 5; Tr. at p. 104 (Tonyan).

[20] Tr. at p. 279-81 (Tonyan).

[21] Tr. at p. 463-466 (Horn).

[22] Tr. at p. 368, 465 (Horn).

[23] Tr. at p. 725 (Respondent 3).

[24] Tr. at 368, 370 (Horn).

[25] Tr. at p. 230-232 (Sampat); 545-546 (Respondent 3).

[26] Tr. at 665 (Respondent 3).

telephone conversation indicating that the firm expected to file ten customer complaints.[27] From the conversation, Sampat believed that Northwestern would report the complaints to NASD.[28]

However, Northwestern did not report the complaints. Instead, Northwestern continued to wait for the NASD examination. Horn did not ask Respondent 3 to seek NASD guidance on how to report the complaints, and Respondent 3 confirms that he did not do so.[29] The predicted time for the examination came and went, with no word from NASD. Respondents did not revisit their decision to wait for NASD to call, and they did not contact NASD to discuss the issue or seek guidance.[30]

However, Northwestern had a prime opportunity to broach the issue of the unreported complaints on February 21, 2001, when Horn, Respondent 3 and Rosenbaum traveled to Chicago to meet with NASD staff to discuss the possible registration of a new broker dealer with NASD Field Supervisor David Moody and his supervisor, Mike Levickas - the very NASD staff in the best position to offer advice about the late reporting.[31] Nonetheless, Northwestern's representatives did not mention the unreported complaints or seek advice about how to report them.[32]

Sometime in June 2001, Moody did contact Respondent 3 to arrange for an examination of Northwestern, which began on July 30, 2001. Just prior to NASD's arrival for the examination, Respondent 3 informed Moody that the Firm had conducted an internal audit regarding Rule 3070

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[27] CX-8; Tr. at p. 230-238 (Sampat).

[28] Tr. at p. 245 (Sampat).

[29] Tr. at p. 508-509 (Horn); Tr. at p. 696 (Respondent 3).

[30] Tr. at p. 467, 468 (Horn).

[31] Respondent 3 Exhibit 1; Tr. at p. 554-556 (Respondent 3).

[32] Respondents claim they felt they did not have time to raise the issue because NASD staff gave them only an hour to meet. Tr. at p. 556 (Respondent 3). The Panel did not find this argument credible. At a minimum, it would have been reasonable for Northwestern's representatives to raise the issue of the unreported complaints at the conclusion of the meeting.

complaint reporting and he wanted to discuss corrective steps with the NASD during the examination.[33] Moody passed on this information to Ms. Tonyan a week or two before the examination, since she was the NASD Compliance Examiner who would be working on the Rule 3070 reporting issues.[34] NASD conducted its examination from July 30, 2001, until August 8, 2001.[35] In response to NASD's checklist request, at the beginning of the examination Northwestern provided NASD with a list of complaints from May 1999 through June 2001, highlighting 80 complaints that Northwestern believed should have been reported.[36] As part of the examination, NASD staff reviewed all complaints on the list to determine whether the staff agreed with Northwestern's conclusions.[37]

At NASD's examination exit interview with the firm on August 8, 2001, the NASD staff noted that it still needed copies of 26 of the 80 customer complaints on Northwestern's list.[38] Immediately following the exit interview, Respondent 3 raised with Moody the issue of how to report the complaints. Moody told Respondent 3 that the complaints had to be reported, but that he would get back to him about how to report them; he wanted to talk to his supervisor, Mike Levickas, about it first.[39]

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[33] Tr. at p. 558 (Respondent 3); Tr. at p. 283-284 (Moody).

[34] Tr. at p. 74, 75, 223 (Tonyan); Tr. at p. 284-287 (Moody).

[35] Tr. at p. 74, 86 (Tonyan).

[36] Tr. at p. 79-82, 202-03; Tr. at p. 559 (Respondent 3); CX-10. The remaining complaint files were then forwarded to the Staff for its independent review after the examination. Tr. at p. 89-90 (Tonyan).

[37] Tr. at p. 80-81 (Tonyan).

[38] CX-24; Tr. at p. 81-83, 95 (Tonyan). Respondent 3 testified that he did not understand why the staff requested these complaints, since they had already been provided. Tr. at p. 561-562 (Respondent 3).

[39] CX-11; Tr. at p. 84-86 (Tonyan); Tr. at p. 255-56, 265-266, 291, 295-297 (Moody).

During subsequent conversations in August and September 2001, Moody again indicated that the complaints had to be reported, and Respondent 3 understood this.[40] However, Moody did not advise Respondent 3 about *how* the complaints should be reported.[41]

Northwestern reported all but two of the complaints between December 28, 2001, and January 7, 2002, after several calls from the NASD urging that the complaints must be immediately reported in order to close out the examination by year end.[42] The first of the two other complaints, which was received on January 29, 2001, had been reported earlier, on July 13, 2001.[43] The firm reported the second, November 12, 1999, complaint, on May 8, 2003.[44]

B. Arbitration Settlement Reporting and Form U-5 Update

Rule 3070(a) and (b) generally require settlements with customers to be reported within 10 days of the settlement. Northwestern does not dispute that it failed to comply with these requirements. In particular, on September 21, 2000, Northwestern settled an arbitration with JF for $83,780. Northwestern reported this matter to NASD over two years later, on October 29, 2002.[45] On December 13, 2000, Northwestern settled an investment-related customer complaint with JS &

[40] Id. Respondents argue that Moody did not direct Northwestern to report the complaints during this August through September time period. Post hearing brief at 8. The Panel found that although Moody may not have directed Respondents *to immediately report* the complaints once he learned of them, he nonetheless did inform Respondent 3 that the complaints *had to be reported.* In that regard, while Respondent 3 testified that Moody did not tell him to immediately report the complaints, and that Moody did not give Northwestern "formal" directions, he acknowledged that Northwestern would be required to report the complaints. Tr. at p. 558-559, 564, 703-704.

[41] Tr. at p. 268-74 (Moody). Respondent 3 claimed that Moody did not tell him to report the complaints until late December 2001. Tr. at p. 564 (Respondent 3). The Panel found that Moody did tell Respondent 3 that the complaints must be reported throughout their discussions, but Moody undertook to get back to Respondent 3 about how they should be reported.

[42] CX-13; CX-14; CX-15; Tr. at p. 97-101 (Tonyan).

[43] CX-5 at 156-59; CX-20 at 78; Tr. 86-87 (Tonyan); CX-11.

[44] CX-20 at 37.

[45] Tr. 111-12 (Tonyan); CX-6; CX-21.

DS on its own behalf and on behalf of one of its registered representatives by restoring variable annuities valued at $71,930.05.[46] Northwestern reported this matter on September 16, 2003.

Similarly, Northwestern admitted that one of these settlements pertained to a former registered representative, and that it failed to report it as an amendment to the former registered representative's Form U-5 within 30 days, as required under Article V, Section 3(b) of the NASD By-Laws. In particular, while the matter was settled on December 13, 2000, Northwestern did not file the amended Form U-5 disclosing the settlement until January 25, 2001.[47]

IV. <u>Violations</u>

A. Reporting Violations Relating to Customer Complaints - Rules 3070 and 2110

1. Northwestern

Enforcement alleges that Northwestern failed to timely report customer complaints in violation of Rules 3070 and 2110. Rule 3070(c) provides "Each member shall report to the Association statistical and summary information regarding customer complaints by the 15th day of the month following the calendar quarter in which the customer complaints are received by the member." It is important that members comply with Rule 3070 by timely reporting customer complaints. Among other things, this information assists NASD staff in detecting and investigating sales practice violations.

Northwestern does not dispute the violation, and the Panel independently finds that Northwestern failed to timely report at least 76 customer complaints, violating Rule 3070. By violating that rule, Northwestern also violated Rule 2110.

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[46] CX-6; Tr. 112-13; CX-21.

[47] CX-7; Tr. 113-14.

2. Horn

Enforcement alleges that Horn violated Rules 3070 and 2110 by failing to timely report customer complaints once she became aware of them. As noted above, Rule 3070(c) requires the reporting of statistical and summary information regarding customer complaints by the 15th day of the month following the calendar quarter in which the customer complaints are received.

Horn argues that Rule 3070(c) does not apply to her because the language of the rule refers only to NASD member firms, not associated persons. This argument is unpersuasive. It is well settled that "[u]nder NASD Rule 115, associated persons have the same duties and obligations as NASD members under NASD's rules."[48] As recognized in recent decisions, persons responsible for compliance with Rule 3070 may be held liable for a member firm's failure to comply.[49]

Horn also argues, as does Respondent 3, that because the deadline for disclosing the complaints under Rule 3070 had already passed when she became aware of them, she cannot be held to have violated the rule. She argues that Rule 3070 says nothing about "contributing to the delay" in reporting complaints, and therefore, the rule cannot be applied to her. Respondent 3 argues the same general point. For the reasons set forth below in the discussion of Respondent 3's violation, the Panel rejects this argument.

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[48] Dep't of Enforcement v. Mizenko, No. C8B030012, 2004 NASD Discip. LEXIS 20, at *12 n.7 (NAC Dec. 21, 2004), appeal docketed, No. 3-11806 (SEC Feb. 2, 2005) (extending NASD Conduct Rule 2110 to all associated persons). See also In re Manoff, Exchange Act Release No. 46,708, 2002 SEC LEXIS 2684, at *2 n.1 (Oct. 23, 2002) (confirming that "associated persons have the same duties and obligations as NASD members under the NASD's rules."); In re Jawitz, Exchange Act Release No. 44,357, 2001 SEC LEXIS 1042, at *2 n.2 (May 29, 2001) (establishing that NASD Conduct Rules 2110, 2120 and 3310 apply to associated persons by virtue of NASD Rule 0115); Dep't of Enforcement v. U.S. Rica Financial, Inc., No. C01000003, 2003 NASD Discip. LEXIS 24, at *13 n.4 (NAC Sept. 9, 2003) (extending NASD Conduct Rule 2210 to all associated persons); Dep't of Enforcement v. Puma, No. C10000122, 2003 NASD Discip. LEXIS 22, at *12 n.6 (NAC Aug. 11, 2003) (Noting that NASD Conduct Rule 2110 applies to associated persons because "[p]ersons associated with a member shall have the same duties and obligations as a member under these Rules.").

[49] Dep't of Enforcement v. Investment Management Corp. and Kevin D. Kunz, No. C3A010045, 2003 NASD Discip. LEXIS 47 *21-22 (NAC Decision, December 15, 2003); Dep't of Enforcement vs. Yankee Financial Group, Inc.,

Horn was Northwestern's Compliance Officer during the time that the complaints were uncovered; she was fully aware that the complaints had not been reported, and she failed to take reasonable steps to comply with the rule. Accordingly, the Panel finds that she violated of Rule 3070(c), and by doing so also violated Rule 2110.

3. Respondent 3

Enforcement also alleges that Respondent 3 violated Rules 3070 and 2110 based on his participation in the failure to timely report customer complaints once he became aware of them.

Respondent 3 argues, as did Horn, that because he did not become aware of the unreported complaints until after they were already late, he cannot be held liable. He points to the wording of Rule 3070(b), which requires member firms to report certain specified conditions to NASD within 10 days after the time the member "knows or should have known" of the existence of the condition. He contrasts this with the wording of Rule 3070(c), which requires members to report customer complaints to NASD "by the 15th day of the month following the calendar quarter in which customer complaints are received by the member." He argues that this wording in Rule 3070(c) establishes that, if the responsible person does not become aware of customer complaints until after the deadline for reporting passes, the rule imposes no further obligation to report the complaints to NASD.

The Hearing Panel finds this interpretation of Rule 3070(c)'s requirements nonsensical and rejects it. Instead, the Panel finds that Rule 3070(c) imposes a continuing obligation on member firms and their responsible personnel to promptly report customer complaints, even if they do not become aware of them until after the deadline established in Rule 3070(c). To hold otherwise

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Richard F. Kressge and Joseph C. Korwasky, No. CMS030182, 2004 NASD Discip. LEXIS 56 *60-61 (appeal docketed, January 5, 2005).

would allow member firms and their responsible personnel to avoid their obligations under the rule simply by avoiding knowledge of customer complaints until the reporting deadline had passed. Moreover, even if Respondent 3's interpretation of Rule 3070(c) were correct – that is, Northwestern violated Rule 3070(c) when it failed to timely disclose the complaints and the rule imposes no continuing obligation to disclose complaints discovered after the deadline has passed – the Panel would still find that the Firm, Respondent 3 and Horn had an obligation under the general provisions of Rule 2110 to report the complaints as soon as they became aware of them.

While Respondent 3 was not the Chief Compliance Officer when Northwestern discovered the complaints and failed to report them, the SEC has held that a registered person cannot avoid responsibility for a member's failure to comply with NASD rules simply because he is not the final decision maker.[50] Once a registered person becomes aware of a member's failure to meet its obligations under NASD rules and is involved in formulating management's response, he or she must take appropriate steps to address the misconduct.[51] Because Respondent 3 knew that Northwestern had failed to disclose the complaints, in violation of Rule 3070, and took an active, though subordinate, role in the decision not to report them after they were discovered, the Hearing Panel found that he violated Rules 3070 and 2110.

B. Failure to Supervise

Enforcement alleges that Northwestern failed to properly train its registered representatives and other personnel with respect to the handling of customer complaints, and thereby violated NASD Conduct Rule 3010.

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[50] In re Franklin N. Wolf, 52 SEC 517, 524, 1995 SEC LEXIS 3230, at *19-20 (Nov. 29, 1995).

[51] In re John H. Gutfreund, et al., 51 SEC 93, 113, 1992 SEC LEXIS 2939, at *48-49 (Dec. 3, 1992).

Rule 3010 requires that NASD members "establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [NASD]." The standard of "reasonableness" is determined based on the particular circumstances of each case. The burden is on Enforcement to show that the respondent's conduct was not reasonable.[52] A failure to "adequately maintain and enforce supervisory procedures" is also a violation of NASD Conduct Rule 2110.[53]

Rule 3010(d)(2) specifically requires firms to have written procedures to review incoming written correspondence in order to identify customer complaints and ensure they are properly handled.[54] The rule emphasizes the need for education and training about these procedures, documentation of such training, and surveillance and follow-up to ensure compliance. In 1999 NASD issued Notice to Members 99-03, which highlighted these obligations and acknowledged that members may utilize unregistered persons to review correspondence <u>if they have received sufficient training to enable them to identify complaints</u>. NASD previously issued other Notices underscoring the importance of procedures for the review and handling of written complaints.[55]

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[52] <u>Dist. Bus. Conduct Comm. v. Lobb</u>, 2000 NASD Discip. LEXIS 11, at *16 (NAC Apr. 6, 2000) (citations omitted).

[53] <u>See</u> <u>Dist. Bus. Conduct Comm. v. A.S. Goldmen & Co.</u>, No. C10960208, 1999 NASD Discip. LEXIS 18, at **44-45 (NAC May 14, 1999).

[54] Release No. 34-40723; File No. SP-98-52.

[55] On December 31, 1997, the SEC approved amendments to Rule 3010, which required that member firms develop flexible supervisory procedures for the review of correspondence with the public. <u>Notice to Members 98-11</u>, at 59 (January 1998). In this notice, NASD gave member firms guidelines for the supervision and review of correspondence, and stated that the member's supervisory policy and procedures must state that "all customer complaints, whether received via e-mail or in written form from the customers, are reported to the NASD in compliance with Rule 3070(c)." <u>Id.</u> at 60-61. The Notice also said "education and training must be timely (prior to or concurrent with implementation of the policies and procedures) and must include all appropriate employees." <u>Id.</u>

Northwestern did not heed these NASD Notices, and Respondent 3 could recall no training as to procedures for handling written customer complaints until January 2001, after the issue of the unreported complaints surfaced.[56] It is undisputed that prior to this, Northwestern failed, at least 76 times, to properly route complaints to Northwestern's equity compliance department. Respondent 3 believed that "the root cause of the violation of 3070 [stemmed] from a lack of education or ignorance."[57] Northwestern's mishandling of unreported complaints was widespread, including the mailroom at Northwestern's headquarters, the Chief Executive Officer's office, and the Compliance Best Practices Department of Northwestern Mutual Life Insurance.[58]

Accordingly, the Panel found that Northwestern failed to properly train its registered representatives and other personnel with respect to the handling of customer complaints, and thereby violated NASD Conduct Rules 3010 and 2110.

C. Failure to Report Arbitration Settlements and Amend Form U-5

Enforcement alleges that Northwestern violated Rule 3070(a) and (b), which requires members to report customer settlements in excess of $15,000 within 10 business days after the member knows, or should have known, of the settlement. Northwestern admits that two arbitration settlements were not reported within 10 business days as required under rule 3070, so these violations are not in dispute. In particular, Northwestern failed to report its September 21, 2000, $83,780 settlement of an arbitration until over two years later, on October 29, 2002, and it failed to report a December 13, 2000, $71,930.05 settlement of a customer complaint until September 13, 2003. Accordingly, and as Northwestern does not dispute, the Panel found that Northwestern violated Rules 3070(a) and (b).

[56] Tr. at p. 616-619 (Respondent 3).

[57] CX-16 at p. 5.

Similarly, Northwestern admitted that it failed to file a timely amendment to a former registered representative's Form U-5 reporting one of these settlements, as required under Article V, Section 3(b) of the NASD By-Laws. In particular, while the matter was settled on December 13, 2000, the amended Form U-5 disclosing the settlement was not filed until January 25, 2001. Accordingly, and as Northwestern does not dispute, the Panel found that Northwestern violated Rule 2110.

V. Sanctions

A. Late Reporting; Rules 3070 and 2110

1. Northwestern

For late reporting violations under Rule 3070, the NASD Sanctions Guidelines ("Guidelines") recommend that Adjudicators impose a fine of $5,000 to $50,000, and, in egregious cases, consider suspending the responsible principal in any or all capacities for up to two years, or barring the principal in all supervisory capacities. NASD SANCTION GUIDELINES, at 78 (2005 ed.).

Enforcement requests that the Hearing Panel impose a censure and fine of $80,000 on Northwestern for the Rule 3070 late complaint reporting violations, which amounts to approximately $1,000 per complaint. Enforcement urges that a sanction above the guidelines is appropriate because Northwestern's misconduct was egregious. However, the Panel applied the "Principal Considerations" suggested in the Guidelines, and concludes that a $50,000 fine – the maximum of the range in the Guidelines – is justified.

In making this determination, the Panel first considered the length of the delay in reporting, which, being generous to Respondents, began in late October 2000, after Northwestern had fully investigated the complaints and identified at least 76 complaints that should have been reported,

[58] Tr. at p. 606-619 (Respondent 3); Tr. at p. 404-405 (Horn).

continued past the July 2001 examination, and ended in January 2002, when the bulk of the complaints was reported.

The Panel was not persuaded by Northwestern's argument that it self-reported the violation to Sampat, during Respondent 3's call in late October or early November 2000. The Panel gave little weight to Northwestern's self-reporting, because Respondent 3 appeared to understate the issue by referring to only "a few" complaints, when Northwestern had already uncovered most or all of the 76 unreported complaints. Moreover, Respondent 3 told Sampat that the complaints would be reported shortly and warned of a possible "spike," but either before or shortly after this call, Northwestern decided not to report the complaints until its NASD examination.[59] Self-reporting is not a "get out of jail free" card, particularly when a respondent understates the extent of the violation and leaves NASD staff with the misimpression that the violation will promptly be corrected.

The Panel also considered that Northwestern did not promptly take action to report the complaints or seek clarification once the violations were uncovered. In that regard, the Panel found that Northwestern acted unreasonably in waiting for the next examination to address the issue of reporting complaints. Once a reporting error is detected, it should promptly be rectified.[60] The

[59] It is unclear whether Respondents made the determination to delay reporting the complaints before or after Respondent 3's conversation with Sampat. However, giving Respondents the benefit of the doubt that the determination was made after the call, it was then, at a minimum, Respondents' responsibility to correct the misimpression left with Sampat that the complaints would be reported.

[60] Due to Northwestern's knowing delay in reporting, and the large number of complaints, the Panel rejected the notion that lengthy delays in reporting some 76 complaints could be viewed as a minor rule violation rather than a disciplinary matter.

notion that somehow it might have been possible not to report the complaints at all because they had not occurred in the most recent quarter is simply not reasonable. The Panel was particularly troubled by the fact that Northwestern did not take the opportunity, placed at its doorstep, to bring the issue to the NASD's attention during a February 2001 in person meeting in Chicago, where Horn, Respondent 3 and other Northwestern representatives were present with the senior NASD staff member who could have provided guidance. Had Northwestern truly wanted to flag the issue and get guidance, this would have been a natural time to do it.[61]

Respondents point out that NASD staff had full disclosure of the unreported complaints in connection with its examination, which began on July 31, 2001. However, this does not excuse the eight months of silence that preceded the examination. Nor is providing information during an examination sufficient to comply with the reporting requirements of Rule 3070.

The Panel was also not persuaded by Northwestern's attempt, after the examination was underway, to shift the burden to NASD examiners to advise Northwestern on how to report the complaints. It is undisputed that during the examination Respondents asked NASD staff for guidance as to how the complaints should be reported and that the staff failed to advise them. However, it is well established that a member or associated person may not shift the burden of compliance with regulatory requirements to NASD.[62] Northwestern's attempts to shift the burden to NASD exhibited to the Panel a refusal to take responsibility for its own misconduct. As such, it is an aggravating factor, not a mitigating one.[63]

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[61] The Panel did not credit Respondents' explanation that they could not raise the issue at this meeting because the NASD limited the meeting to one hour.

[62] Joseph H. O'Brien, Securities Exchange Act Release No. 34105 (May 25, 1994) 51 SEC Docket 11112, 1116; B.R. Stickle & Co., Securities Exchange Act Rel. No 33705 (March 3, 1994) 56 SEC Docket 497, 501.

[63] Dep't of Enforcement v. Tretiak, Complaint No. C02990042, 2001 NASD Discip. LEXIS 1 at *57 (NAC Jan 23, 2001), aff'd, Robert Tretiak, Exchange Act Rel. No 47534, 2003 SEC LEXIS 653 (Mar. 19, 2003).

On the other hand, in rejecting Enforcement's request for an upward departure from the Guidelines, the Panel noted that Northwestern staff, and in particular, Respondent 3, made great efforts to determine the extent and reasons for the unreported complaints. Moreover, Northwestern conducted training and instituted extensive procedures to assure themselves that the problem would not recur. Taking all these factors into consideration, the Panel concluded that a fine at the top of the recommended range is appropriate.

2. Horn – Failure to Timely Report Customer Complaints

Enforcement requests that the Panel impose a censure and a fine of $15,000 on Horn for her violation of Rules 3070 and 2110. Applying the factors or "Principal Considerations" suggested in the Guidelines, the Panel finds that a censure and a fine of $15,000 are appropriate in this case. In making this determination, the Panel considered that Horn was the Chief Compliance Officer and as such had overall responsibility for compliance with NASD rules. Even if Horn was not the final decision-maker, she was the Chief Compliance Officer, and therefore it was her responsibility to take reasonable steps to ensure that Northwestern complied with Rule 3070. Instead, although she was well aware that Northwestern had failed to report at least 76 customer complaints, she was complicit in Northwestern's decision to defer reporting them. Under these circumstances, the Panel concludes that a $15,000 fine, well above the minimum recommended in the Guidelines, and a censure are appropriately remedial sanctions.

3. Respondent 3

Enforcement requests that the Hearing Panel impose a censure and a fine of $7,500 on Respondent 3 for his involvement in Northwestern's failure to timely report customer complaints in violation of Rules 3070 and 2110.

Applying the factors or "Principal Considerations" suggested in the Guidelines, the Panel finds that a censure and a fine of $5,000 is appropriate in this case. In reaching this determination, the Panel considered that when Respondent 3 first became aware that Northwestern had failed to report a customer complaint, he took appropriate action to discover the full extent of the problem and reported it to Horn, his superior. Further, although Respondent 3 recommended that Northwestern delay reporting the complaints until the examination, he was not the Chief Compliance Officer at the time, and was not the person who ultimately decided that Northwestern should delay reporting the complaints. On the other hand, Respondent 3 appeared to understate the scope of the problem when he spoke with Sampat in October 2000, and left her with the impression that Northwestern would file the unreported complaints shortly. Under these circumstances, the Panel concludes that a censure and a $5,000 fine, at the bottom of the range recommended in the Guidelines, are appropriately remedial sanctions.

B. Failure to Supervise

For failure to supervise violations under Rule 3010, the Guidelines recommend a fine of $5,000 to $50,000. NASD SANCTION GUIDELINES, at 108 (2005 ed.). Enforcement requests that the Panel impose a censure and a fine of $10,000 on Northwestern for its failure to properly train individuals regarding the handling of customer complaints. Applying the "Principle Considerations" set forth in the Guidelines, the Panel finds that a higher fine, at the top of the range recommended in the Guidelines, is appropriate in this case. In particular, the Panel considered the lack of institutional control over customer complaints and the Rule 3070 process, including widespread lack of training of responsible personnel in the proper handling of complaints, evidenced by the large number of undetected, unreported complaints across a number of departments within Northwestern, spanning several years. Although Northwestern subsequently conducted training, the Panel believes that a $50,000 fine, together with a censure, is required to impress upon Northwestern and other NASD members the critical importance of supervision to ensure accurate complaint reporting under Rule 3070.

C. Late Reporting of Settlements and Filing of Form and U-5 Amendment

For the late reporting of settlements, the Guidelines recommend that Adjudicators impose a fine of $5,000 to $100,000. For late filing of Forms U-5 in violation of Article V of the NASD by-laws, the Guidelines recommend a fine in the same range.[64] Northwestern clearly knew that these matters were settled, because they paid for them. However, it offered no explanation for its failure to timely report them and to timely file a Form U-5 amendment, both of which are essential to ensure that NASD has an opportunity to conduct an investigation, if warranted. Enforcement requested a fine of $5,000 for the failure to report the two settlements, and a $5,000 fine for the failure to promptly amend the Form U-5. The Panel agrees that these $5,000 fines, at the low end of the range in the Guidelines, were appropriate in this case, particularly given the small number of instances and Northwestern's acceptance of responsibility for the violations. In addition, while the Guidelines provide that ordinarily censures are not imposed for reporting violations where the fine is $5,000 or less, because these violations aggregate to more than $5,000, the Panel believes that a censure is also justified under the Guidelines.[65]

VI. Conclusion

For the failure to timely report customer complaints Respondent Northwestern is censured and fined $50,000; Respondent Horn is censured and fined $15,000; and Respondent 3 is censured

[64] NASD SANCTION GUIDELINES, at 74, 78 (2005 ed.).

[65] The Hearing Panel has 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.

and fined $5,000. In addition, Respondent Northwestern is censured and fined $50,000 for the failure to supervise, censured and fined $5,000 for the failure to timely report settlements, and censured and fined $5,000 for the failure to timely amend a Form U-5. Finally, Respondents are ordered, jointly and severally, to pay costs in the amount of $5,625.50, which includes an administrative fee of $750 plus the cost of the hearing transcript. These sanctions become effective at a time set by NASD, but not sooner than 30 days after this Decision becomes the final disciplinary action of NASD.

HEARING PANEL

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Sara Nelson Bloom
Hearing Officer

Dated: July 29, 2005

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