BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of the Association of X as a General Securities Representative with The Sponsoring Firm	**Redacted Decision** Notice Pursuant to Section 19h-1 Securities Exchange Act of 1934 SD99014

On July 16, 1998, a member firm ("the Sponsoring Firm" or "the Firm") submitted an MC-400 application ("Application") to permit X[1], an individual subject to two statutory disqualifications, to associate with the Sponsoring Firm as a general securities representative.[2] In February 1999, a subcommittee of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") ("Hearing Panel") held a hearing on the matter. X appeared at the hearing and was represented by counsel. X was also accompanied by his proposed supervisor ("the Proposed Supervisor"). BA appeared on behalf of the Department of Member Regulation ("Member Regulation").

[1] The names of the Statutorily Disqualified individual, the Sponsoring Firm, the Proposed Supervisor, and other information deemed reasonably necessary to maintain confidentiality have been redacted.

[2] X entered the securities industry in April 1975 as a general securities representative. He was associated in that capacity with Firm A, and Firm B, from 1975 to 1989, and with Firm C from 1993 to 1995.

The first statutory disqualification is based on X's conviction for securities fraud, a felony. The criminal conviction, entered in 1989, constitutes a statutory disqualification for a period of 10 years.[3] In 1988, X and five others were indicted in a United States District Court on a conspiracy count for mail and wire fraud in connection with the reporting of gains and losses on "tax trades" conducted by Firm B, where X was a general partner.[4] They were also charged, separately from the conspiracy count, with wire and mail fraud in connection with the tax trades at issue. The indictment also charged X and the others with conspiracy for engaging in securities fraud related to a scheme to manipulate, and attempts to manipulate, the common stock of Firm D, in violation of Section 10(b) of the Exchange Act and Rule 10b-5. X and two other defendants were also charged, separately from the Firm D conspiracy count, with wire and securities fraud in connection with the Firm D securities transactions. The indictment also charged all of the defendants with violating the Racketeer Influenced Corrupt Organizations Act ("RICO") as co-conspirators on the tax trades and the securities fraud.

X and the other defendants were convicted of the charges in November 1989, after a jury trial. On appeal, the United States Court of Appeals vacated and remanded for further proceedings the convictions of all of the defendants except for the convictions of X and another defendant on the conspiracy and securities fraud counts.[5] The government brought no further action against any of the defendants as a result of the convictions that had been vacated and remanded.

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[3] Under Sections 3(a)(39) and 15(b)(4)(A) of the Exchange Act of 1934 (the "Exchange Act"), a person is subject to a statutory disqualification if he "has been convicted within ten years . . . of any felony or misdemeanor . . . which . . . arises out of the conduct of the business of a broker, dealer . . . ." The statutory disqualification represented by the November 1989 conviction therefore will expire in November 1999.

[4] X was a general partner and the head trader of Firm B, a now-dissolved hedge fund limited partnership which employed him from 1975 until 1989.

[5] On appeal, the Court of Appeals affirmed the conspiracy convictions and vacated and remanded the convictions of four of the defendants (not including X) on all other charges (RICO, securities fraud, mail and wire fraud in connection with tax trades). As to X and one other defendant, the Court of Appeals vacated and remanded the RICO convictions and wire and mail fraud convictions in connection with the tax fraud charges, but affirmed the conspiracy and securities fraud convictions.

Subsequent to the issuance of the Court of Appeals' opinion in 1991, the four defendants who were convicted solely on the conspiracy charge moved to have their conspiracy convictions vacated. Later that same year, the Court of Appeals issued an Order Amending Opinion, in which it vacated and remanded the conspiracy count as to each of the four defendants. The court stated that "the participants in the trial below all appear to have assumed that these four defendants were not involved in the alleged securities fraud and there is little proof to justify a finding to the contrary." The court concluded that the jury had considered the conspiracy count against the four defendants only as it related to the alleged tax frauds.

X and the other defendant whose conviction was upheld on appeal subsequently sought modification of their sentences, pursuant to Federal Rule of Criminal Procedure 35. In September 1992, a United States District Court Judge vacated all sentences and fines imposed on X and the other defendant. The judge noted in his opinion that the major actors in the case had not been found guilty and that X had been a minor participant. Despite the Judge's decision to vacate X's sentence, however, X's criminal conviction was not overturned.

As a result of X's criminal conviction, the Securities and Exchange Commission ("Commission") issued a bar order in 1993, which subjected X to a second statutory disqualification.[6] Based on an offer of settlement by X, the Commission entered its order barring X from association with any broker, dealer, investment company, municipal securities dealer or registered investment advisor. Prior to the issuance of the bar order, however, X's attorneys negotiated a "carve-out" exception so that X would be permitted to pursue employment as an unregistered investment adviser without violating the bar order.

As a result of the "carve-out" exception to the bar order, X worked for Firm C, a subsidiary of Firm E, as an unregistered investment advisor from 1993 through 1995.[7] During the course of that employment, X was responsible for certain proprietary trading, primarily with respect to Japanese derivative securities. In an affidavit that was filed in this matter, the Managing Director at Firm E stated that "[t]he fact that [X] is no longer in our [Firm E] employ was not indicative of his ability or integrity." The Managing Director explained that "the foreign markets that [X] traded became unproductive and unprofitable for Firm E" and that X " was one of many traders who suffered because of the lack of opportunity in these specific markets." Since X's departure from Firm C in April 1995, he has been unemployed, but has made an effort to remain current with developments in the securities industry.[8]

The Court of Appeals found that the district court had committed prejudicial error that tainted all of the tax fraud charges by failing to instruct the jury to consider how all six of the defendants in good faith had interpreted the applicable tax code section at issue (26 U.S.C. §1058). The Court of Appeals found that section 1058 "became pivotal in the case because the [defendants] believed that section 1058 authorized them to do just what they did, i.e., take tax losses." Notwithstanding this finding, the Court of Appeals nevertheless affirmed X's and one other defendant's convictions on the conspiracy count, which count included the tax fraud allegations.

[6] See Section 3(a)(39) of the Exchange Act.

[7] At the time of X's employment, Firm C was engaged in trading and investing for its own account in financial instruments, including securities of foreign issuers listed on American exchanges, Japanese securities, Eurodollar convertible securities, futures and other foreign financial instruments. During his employment at Firm C, X usually worked alone in the office since he was primarily trading in markets that were open during the night and very early morning (U.S. time).

[8] X represents that he has attempted to stay current regarding securities industry matters by checking information on Bloomberg terminals and by regularly reading securities industry publications

The Sponsoring Firm, a wholly-owned subsidiary of Firm F, became a member of the NASD in November 1996 and is registered with the Commission under Section 15(b) of the Exchange Act. According to the proposed supervisor, the Sponsoring Firm was founded to provide money managers with trade execution (on an agency basis), research, accounting, compliance, and other services through the conversion of commissions. If employed by the Sponsoring Firm, X would solicit new business, accept customer orders, execute customer orders through other registered broker/dealers as agent, and provide market information to the Sponsoring Firm's customers on certain securities.

The Sponsoring Firm has one office, and the Firm employs five general securities principals, four registered representatives, and five employees. The Sponsoring Firm has no formal disciplinary history. After a routine examination of the Sponsoring Firm in May 1997, the NASD Regulation entered into negotiations with the Firm regarding staff's concern that the Sponsoring Firm had an inadequate continuing education plan. No formal action has been filed against the Sponsoring Firm.

The Proposed Supervisor has been employed in the securities industry continuously for 30 years. From 1967 to 1995, the Proposed Supervisor worked in various capacities at Firm G. As a managing director of Firm G, the Proposed Supervisor structured and developed a wholesale distribution strategy in Canada and Europe for fixed income securities. Later, as president and chief executive officer of Firm N, he managed a correspondent clearing business. He also managed Firm I, Firm G's commission conversion (soft dollar) business. His responsibilities over the years have included finance, legal, operations, systems and communications, marketing, sales, and equity and fixed income trading.

Discussion

After careful review of the entire record in this matter, we conclude that the Sponsoring Firm's application to employ X as a general securities representative should be approved. We note that NASD's Department of Member Regulation has recommended that X's association with the Sponsoring Firm be approved.

Statutory Disqualification Based on Criminal Conviction. Although X's criminal conviction was a serious statutorily disqualifying event because it involved securities fraud, we note that the statutory disqualification arising from the criminal conviction ends later this year. Thus, but for the Commission bar order, X would be eligible to reenter the securities industry later this year without submitting to eligibility proceedings.

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and the Wall Street Journal. In October 1995, X traveled to Moscow to attend a Dow Jones conference on Russian securities markets. During that trip, he met with government officials and major brokers to explore the trading opportunities in Russian securities. Additionally, X took the Series 7 General Securities Representative Examination in October 1998, and passed with a score of 94 percent.

Statutory Disqualification Based on Commission Bar Order. In addition to the statutory disqualification based on the criminal conviction, X is statutorily disqualified based on the bar order that the Commission imposed in 1993. As noted earlier, the Commission bar order was issued based on the same misconduct encompassed in the criminal matter.

When the Commission issued the bar, it was expected that bars that had been imposed by the Commission would be eligible for review after five years, absent any misconduct during the intervening period. It was thus standard practice at that time for individuals who were subject to a Commission bar to apply for reentry into the industry after the five-year period had elapsed.[9] X made it clear in his application that he was guided by that practice. In his application to become associated with the Sponsoring Firm, X stated that it had been his understanding that he would be permitted to make an application for reentry to the industry five years after consenting to entry of the bar order. (The Commission imposed X's bar order in 1993.)

After a careful review of the facts, we approve X's association with the Sponsoring Firm. We have considered the following relevant circumstances in making our determination: (1) the length of time since the disqualifying conduct (13 years) and the fact that the statutory disqualification arising from the criminal conviction ends later this year; (2) the fact that the industry standard at the time that X's bar was imposed was that Commission bars would be eligible for review after five years, absent any intervening misconduct; (3) the fact that X has had no other blemish on his record either before or after the disqualifying event; (4) the unblemished track records of the Sponsoring Firm and the Proposed Supervisor; and (5) the fact that X will be subjected to extremely well-qualified supervision. We also note that a number of these enumerated circumstances have been the basis for the Commission's allowing reentry into the securities industry of individuals who previously had been barred.

We approve the following plan of supervision, as proposed by the Sponsoring Firm and approved by Member Regulation, and as revised, in part, by the Hearing Panel during the statutory disqualification hearing:

1) The supervisory procedures of the Sponsoring Firm will be amended clearly to establish that the Proposed Supervisor is responsible for supervising X.

2) X will not maintain discretionary accounts, with the exception of such accounts on behalf of his family.

3) The Proposed Supervisor will review and approve all of X's new account forms for suitability.

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[9] In a 1994 letter, the Commission clarified its position on bars, but made it clear that such guidance was to be applied on a prospective basis only. The terms of the 1994 letter do not apply to X's bar because his bar order was issued prior to 1994. We are not expressing any opinion as to what the result might be if the bar at issue had been imposed subsequent to the 1994 release.

4) The Proposed Supervisor will review and approve all of X's order tickets on a daily basis.

5) The Proposed Supervisor will review all of X's incoming and outgoing correspondence.

6) The Proposed Supervisor will keep a written record evidencing review and approval of all of X's transactions, the opening of new accounts, and all correspondence.

7) The Proposed Supervisor will meet with X on a quarterly basis to review his transactions with clients. This will entail a review of the distribution of customer funds. A log shall be kept by the Sponsoring Firm of these meeting.

8) All customer complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the Director of Compliance. The Proposed Supervisor will prepare a memorandum to the file as to what measures he took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. Documents pertaining to these complaints should be kept segregated for ease of review.

9) X will be prohibited from accepting funds from customers in his name. Rather, all funds must be payable to either the Sponsoring Firm or the particular fund.

10) X will conduct securities business on behalf of the Sponsoring Firm only from the office where the Proposed Supervisor or his designee is physically located, at a desk near the Proposed Supervisor's; provided, however, that X is allowed to meet off-site with potential customers for the limited purpose of marketing the services of the Sponsoring Firm (including specific strategies).

The NASD certifies that: (1) X meets all applicable requirements for the proposed employment; (2) the Sponsoring Firm is not a member of any other self-regulatory organization; and (3) X and the Proposed Supervisor are not related by blood or marriage.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the registration of X as a general securities principal associated with the Sponsoring Firm will become effective upon the issuance of an order by the Commission that it will not institute proceedings pursuant to Section 15A(g)(2) of the Act. The NASD is also seeking relief under Section 19(h) of the Act. This notice will serve as an application for such an order.

On Behalf of the National Adjudicatory Council,

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Joan C. Conley
Senior Vice President and Corporate Secretary