BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X[1] as a General Securities Representative with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 SD10001 Date: 2010

I. Introduction

On December 22, 2008, the Sponsoring Firm filed a Membership Continuance Application ("MC-400" or "the Application") with FINRA's Department of Registration and Disclosure. The Application requests that FINRA permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as a general securities representative. In October 2009, a subcommittee ("Hearing Panel") of FINRA's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, accompanied by his Proposed Supervisor. FINRA Employee 1, FINRA Attorney 1, and FINRA Attorney 2 appeared on behalf of FINRA's Department of Member Regulation ("Member Regulation").

For the reasons explained below, we deny the Sponsoring Firm.[2]

II. The Statutorily Disqualifying Event

The record shows that X's misconduct was discovered in February 2004 when the director of human resources for X's previous employer, Firm 1, reported to the State 1 police that

[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] Pursuant to FINRA Rule 9524(a)(10), the Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. In turn, the Statutory Disqualification Committee considered the Hearing Panel's recommendation and presented a written recommendation to the National Adjudicatory Council.

X had accessed and stored child pornography on his firm computer. The human resources director was able to find the material that X had accessed, even though X had made attempts to delete the material over a period of several months. The police investigated, and charges were subsequently brought against X in June 2004.

X is statutorily disqualified because in June 2005, he pled guilty in a state court in State 1 to one felony count of sexual abuse of children (possession of visual or print medium in which children were engaged in sexual conduct). In October 2005, the State 1 court imposed on X a fine of $1,000; a suspended sentence of five years in prison; and five years' probation. As a condition of his probation, X was ordered to register as a sexual offender and attend sexual offender counseling ("aftercare or otherwise") for the entirety of his probationary period. X's probation is not due to end until October 2010. Member Regulation stated that X's probation officer verbally represented that X is compliant thus far with the terms of his probation. X's counselor also submitted a written statement attesting that X has completed a sexual offender treatment program and continues to participate in an "aftercare/maintenance group."

III. Background Information

A. X

X first registered in the securities industry as an investment company products and variable contracts limited representative in March 1998, and he qualified as a general securities representative in May 2003. He received a conditional waiver as a general securities representative from FINRA's Qualifications and Testing Department in May 2008, due to the deficient registration status resulting from his disqualification. Accordingly, Member Regulation represents that if X is approved to re-enter the securities industry, he will be qualified to act as a general securities representative.

X was associated with Firm One from January 1998 until February 2004. On a Uniform Termination Notice for Securities Industry Registration ("Form U5") dated March 2004, Firm One stated that X had been terminated for "failure to follow firm policies and procedures."[3] Following his termination from Firm One, X was associated with Firm Two from April 2004 until October 2005. The Form U5 filed by Firm Two on October 2005, states that X voluntarily terminated his employment on that date. The record shows that at the time of his felony charge (June 2004) and conviction (June 2005), X was associated with Firm Two. X did not amend his Uniform Application for Securities Industry Registration or Transfer ("Form U4") to disclose the felony charge, however, until September 2005. By the time he did disclose the felony charge on September 2005, X had already pled guilty and been convicted of a felony. Nonetheless, he did not disclose that conviction on the September 2005 Form U4 amendment—he waited until he filed a further amendment on October 2005. Thus, there was a 14-month gap between X's

[3] At the hearing and in a written statement, X represented that he had resigned from Firm One "due to the shame that [he] felt." X was unable to explain the discrepancy between his version of events and Firm One's reason listed on the Form U5.

felony charge and when he reported it on the Form U4, and a four-month gap between his felony conviction and when he reported it on the Form U5.

X's disclosable history also includes one state misdemeanor conviction in State 1 in 1977 for "attempted theft of gas" that resulted in a $150 fine. In addition, in August 2002, X received a discharge in personal bankruptcy. He reported that the bankruptcy became necessary when he and his wife partnered with another couple to operate multiple restaurants, but the business rapidly declined.

The record shows no other disciplinary or regulatory proceedings, complaints, or arbitrations against X.

B. The Sponsoring Firm

The Sponsoring Firm is based in City 1, State 2, and it has been a FINRA member since August 1980. The Firm represents that it has 43 offices of supervisory jurisdiction, 309 branch offices, 435 registered representatives, and 54 registered principals. The Firm engages in a general securities business.

The Sponsoring Firm's record includes some informal disciplinary actions. FINRA's most recent routine examination of the Sponsoring Firm was conducted in 2008, and it resulted in a compliance conference and a letter of caution ("LOC"). The compliance conference cited the Sponsoring Firm for several violations, including inadequate disclosures in correspondence; failing to review electronic correspondence; failing to address certain Regulation D transactions in the written supervisory procedures; deficient order ticket information; failing to demonstrate the completion of four branch office inspections; advertising violations; and improper direction of commission payments. The LOC cited the Sponsoring Firm for inadequate written supervisory procedures regarding the assignment of qualified supervisors to producing managers and the supervision of customer account activity of producing managers; and for failing to have one producing manager supervised by a senior manager.

FINRA's 2006 routine examination of the Sponsoring Firm resulted in a compliance conference citing the Sponsoring Firm for numerous violations, including failing to update a Form U5 to include a customer complaint; failing to provide notice to FINRA of the Firm's electronic storage of certain records; order ticket records deficiencies; written supervisory procedures inadequacies; incomplete disclosure of representatives' disclosures about outside business activities; books and records violations; and advertising violations.

FINRA's 2004 routine examination resulted in an LOC citing the Sponsoring Firm for certain deficiencies in written supervisory procedures; books and records violations; and failing to report annual municipal securities income.

The record shows no other complaints, disciplinary proceedings, or arbitrations against the Firm.

IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes that X will work as a general securities representative from his home office in City 2, State 1.

The Sponsoring Firm proposes that the Proposed Supervisor will be X's off-site primary supervisor—the Proposed Supervisor will be located at the Firm's OSJ in City 3, State 3. The Proposed Supervisor currently supervises 14 other registered representatives who are located in various places, a few in home offices and the rest in scattered branch offices. The Proposed Supervisor testified that he performs 14-15 office audits per year, one at each representative's location, and also makes regular supervisory visits to the representatives throughout the year. One of the representatives that the Proposed Supervisor currently supervises is subject to firm-imposed heightened supervision as to email review, but that review is conducted in the Firm's home office, and not by the Proposed Supervisor. He has never supervised a statutorily disqualified individual. The Proposed Supervisor is also a producing manager with approximately 100 accredited clients, and that status subjects him to firm-imposed heightened supervisory procedures. He is compensated solely by commission, and he testified that he receives overrides on all of the business written by the individuals that he supervises. The Proposed Supervisor also testified that he expects to receive a similar override on X's business, but that he does not expect to receive any other extra compensation for supervising a statutorily disqualified individual.

The Proposed Supervisor first registered in the securities industry as an investment company products and variable contracts limited representative in July 1983. He qualified as a general securities representative in December 1997 and as a general securities principal in February 2001. He became associated with the Sponsoring Firm in September 2005. Prior to the Proposed Supervisor's association with the Sponsoring Firm, he was associated with various investment or investment-related firms. FINRA's Central Registration Depository ("CRD®") indicates that he voluntarily terminated his association with each of his prior employers.

The record shows two IRS tax liens against the Proposed Supervisor—one filed in July 1997 for $18,046, and one filed in July 2002 for $95,166. At the hearing, the Proposed Supervisor confirmed that the liens remain unsatisfied, and he represented that he and his attorneys are "still arguing" with the government about payment of the tax liens.

The record shows no other criminal, disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

The Sponsoring Firm's Application presents the following description of its plan of heightened supervision for X:

1. The Proposed supervisor plans quarterly visits to X's office for review of office sales materials, prospectuses, call logs, all material on computers and general office environment as well as inspection of client files and review of office procedures. The Proposed Supervisor plans to accompany X on

> appointments with clients and prospects for several days each quarter to review sales practices and advise as needed.

In addition, the Sponsoring Firm's MC-400 represents that the Proposed Supervisor will work "3 full days quarterly" in X's office.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because: 1) the nature of X's disqualification is "very serious and deplorable, related to issues of moral turpitude," and "demonstrates a severe lack of judgment and responsibility on his part"; 2) X remains on probation until October 2010; 3) X has engaged in intervening misconduct by failing to timely amend his Form U4 to disclose his felony charge and subsequent conviction; 4) the proposed plan of supervision is insufficient because the Proposed Supervisor will be located off-site from X and will only visit with X, in his home, three times a quarter; 5) the proposed plan is "skeletal and lacks the proper safeguards to ensure X's compliance with the rules and regulations of the securities industry;" and 6)the Purposed Supervisor is not an "ideal supervisor due to other responsibilities . . . to his other 14 direct reports."

VI. Discussion

A. The Legal Standard

In reviewing this type of application, we consider whether the particular felony at issue, examined in light of the circumstances related to the felony, and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.[4] We assess the totality of the circumstances in reaching a judgment about X's future ability to work in the securities industry in a manner that comports with FINRA's requirements for high standards of commercial honor and just and equitable principles of trade in the conduct of his business. In so doing, we recognize that the sponsoring firm has the burden of demonstrating that the proposed association of the statutorily disqualified individual is in the public interest and does not create an unreasonable risk of harm to the market or investors. *See Continued Ass'n of X*, SD06003, slip op. at 5 (NASD NAC 2006), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/nacdecisions/p036480.pdf (redacted decision).

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[4] *See Frank Kufrovich*, 55 S.E.C. 616, 625 (2002) (upholding FINRA's denial of a statutory disqualification applicant who had committed non-securities related felonies "based upon the totality of the circumstances" and FINRA's explanation of the bases for its conclusion that the applicant would present an unreasonable risk of harm to the market or investors); *see also Timothy H. Emerson, Jr.*, Exchange Act Rel. No. 60328, 2009 SEC LEXIS 2417, at *14 (July 17, 2009) (stating that FINRA "appropriately weigh[ed] all the facts and circumstances surrounding [the applicant's] felony conviction and [the firm's] proposed supervisory plan").

Factors that bear on our assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, whether the person has engaged in any intervening misconduct, and the potential for future regulatory problems. We also consider whether the sponsoring firm has demonstrated that it understands the need for, and has the capability to provide, adequate supervision over the statutorily disqualified person.

After carefully reviewing the entire record in this matter, we find that the Sponsoring Firm has not met its burden, and we conclude that X's participation in the securities industry will present an unreasonable risk of harm to the market or investors. In reaching our conclusion, we considered each of Member Regulation's concerns, which we address below. Accordingly, for the following reasons, we deny the Application for X to associate with the Sponsoring Firm as a general securities representative.

B. The Nature and Gravity of X's Statutorily Disqualifying Event and His Ongoing Probation

First, we note that X was recently convicted of a very serious crime – sexual abuse of children (possession of visual or print medium in which children were engaged in sexual conduct). Further, X's criminal misconduct, while not securities-related, was conducted on his office computer, while he was actively employed in the securities industry at Firm One. Moreover, X's misconduct had the potential to adversely affect numerous persons of minority age. Accordingly, we find that X's activities cast doubt on his character and lead us to question his ability to act in a trustworthy and responsible manner in the securities industry. The Commission has consistently recognized that "[a] propensity for dishonest behavior is of particular concern in the securities industry, an industry that presents numerous opportunities for abuses of trust . . . . [I]n order to ensure protection of investors, the NASD may demand a high level of integrity from securities professionals." *Kufrovich*, 55 S.E.C. at 627; s*ee also William J. Haberman*, 53 S.E.C. 1024, 1029 (1998) (holding that to protect investors and maintain investor confidence in the markets, securities professionals are obliged to maintain high ethical standards), *aff'd*, 205 F.3d 1345 (8th Cir. 2000) (table).

Second, the State 1 court imposed a serious sentence on X, which continues to date. X received a suspended prison sentence of five years, five years' probation, and was required to register as a sexual offender and attend sexual offender counseling for the entirety of the probationary period. The seriousness of this sentence alone connotes the gravity of X's offense. *See Haberman*, 53 S.E.C. at 1028 (finding that the sentence imposed on a statutorily disqualified person "may properly indicate the seriousness of [the] offense"). X remains on probation until October 2010, and he is still participating in aftercare sexual offender counseling. The record shows that if X fails to comply with the terms of his probation, the court could revoke his probation and order him to serve time in prison. The Commission has expressly shared FINRA's concern in not allowing disqualified individuals serving probation to be associated with member firms. *See, e.g.*, *Kufrovich*, 55 S.E.C. at 627-28 ("We share the NAC's concern that Kufrovich remains on probation."); *Funding Capital Fin. Corp.*, 50 S.E.C. 603, 606 (1991) (same); *Michael B. Scheft*, 48 S.E.C. 710, 712 (1987) (same).

We appreciate X's testimony and other evidence about his efforts at rehabilitation, including a letter from his sexual offender counselor. We note that while the counselor stated that X's "profile and personal characteristics . . . occupies (sic) the lowest tier level of risk," the counselor did not represent that X poses no potential future risk to the investing public. X acted irresponsibly and criminally on the Internet accessed through his office computer. We find that the evidence that he proffered does not establish that his association with the Sponsoring Firm would serve the public interest and that insufficient time has passed to enable X to demonstrate that the change in his behavioral pattern is fundamental and long-lasting and that he can conduct himself in a responsible and compliant fashion in the securities industry.

Accordingly, we conclude that the nature and recency of X's conviction, and the pendency of the probationary period through October 2010, militate against allowing X's re-entry into the securities industry at this time.

C. X's Failure to Timely Disclose the Felony Charge and Conviction

We also find that the record does not support X's assertion that he promptly informed Firm Two of his June 2004 felony charge and his June 2005 felony conviction. FINRA's CRD shows that X did not sign and submit an amendment to his Form U4 to disclose the felony charge until September 2005—14 months after he was charged with the felony in June 2004. Moreover, when X disclosed the felony charge on his September 2005 Form U4 amendment, he did not disclose the fact that he had already pled guilty and been convicted of the felony in June 2005. X did not sign and submit an amendment to his Form U4 to reflect the felony conviction until October 2005—four months after the felony conviction. Subsequently, Firm Two submitted a Form U5 representing that X had voluntarily terminated his employment in October 2005.

At the hearing, X argued that he promptly informed his appropriate supervisors (including the Proposed Supervisor, who was X's direct supervisor at Firm Two) about the felony charge, and that he assumed that they were making the necessary amendments to his Form U4. Yet the documentary evidence that he proffered to support his argument—copies of emails back and forth to various persons at Firm Two—shows that the first mention of the felony charge appears to have been July 15, 2004. Thus, even if X's Form U4 had been amended on that date (which it was not), he failed to comply with Art. 5, Sec. 2(c) of FINRA's By-Laws, which requires that Forms U4 be kept current and that all required amendments to Forms U4 be made "not later than 30 days after learning of the facts or circumstances giving rise to the amendment." Further, the Proposed Supervisor acknowledged at the hearing that the disclosure of the felony charge was "probably beyond the 30 days." There is no dispute that X was aware of the felony charge against him on June 8, 2004, but he did not provide timely notice of such charge to his employer or FINRA.

X also admitted that he did not receive an amended Form U4 from Firm Two to sign until September 2005. By that time, X had been convicted of the felony since June 2005, yet he failed to update the Form U4 with the information about the felony conviction until October 11, 2005, more than four months later. X was therefore not in compliance with Art. 5, Sec. 2(c) of FINRA's By-Laws, which requires that Forms U4 must be amended within 10 days after an

event creating a statutory disqualification, such as a felony conviction. *See also NASD Notice to Members 87-65* (Oct. 1987), which warns that the late amendment of a Form U4 may be grounds for denying an application to permit a statutorily disqualified person to associate with a member. Thus, there is also no dispute that X failed to submit an amended Form U4 within the prescribed 10-day period.

While we find X's and the Proposed Supervisor's testimony credible that X informed the Proposed Supervisor about the felony charge in July 2004 and did not intentionally conceal his misconduct from his supervisors at Firm Two, X acknowledged that he did not follow up with his supervisors at Firm Two to ensure that his Form U4 was properly amended. The responsibility for maintaining the accuracy of a Form U4 lies with each registered representative. *Dep't of Enforcement v. Howard*, Complaint No. C11970032, 2000 NASD Discip. LEXIS 16, at *31-32 (NASD NAC Nov. 16, 2000), *aff'd*, 55 S.E.C. 1096 (2002), *aff'd*, 77 F. App'x 2 (1st Cir. 2003); *see also Dep't of Enforcement v. Mathis*, Complaint No. C10040052, 2008 FINRA Discip. LEXIS 49, at *23 (FINRA NAC Dec. 12, 2008), *aff'd*, Exchange Act Rel. No. 61120, 2009 SEC LEXIS 4376 (Dec. 7, 2009), *appeal pending* (2d Cir. filed Feb. 3, 2010). X failed in his responsibility to follow through with Firm Two and make every effort to file a timely amendment to his Form U4.

D. The Sponsoring Firm and the Proposed Supervision

Finally, although we note the lack of formal disciplinary history for the Sponsoring Firm and the Proposed Supervisor, we remain concerned in several respects about the Sponsoring Firm's proposal to supervise X.

A firm that requests FINRA's approval to employ a statutorily disqualified individual must establish that it will be able to adequately supervise the individual by imposing a stringent plan of heightened supervision. *See Emerson*, 2009 SEC LEXIS 2417, at *18. Here, the Sponsoring Firm supplied only the briefest sketch of a plan that provides for the Purposed Supervisor to supervise X's from a remote location and perform "quarterly visits" to X's office "for review of office sales materials, prospectuses, call logs, all material on computers and general office environment as well as inspection of client files and review of office procedures." The proposed plan also mentions that the Purposed Supervisor "plans to accompany X on appointments with clients and prospects for several days each quarter to review sales practices and advise as needed," and the MC-400 states that the Purposed Supervisor plans to "work 3 full days quarterly" in X's office. We find that this plan is inadequate to supervise a statutorily disqualified individual such as X, who was convicted of a felony for accessing illegal child pornography images on a computer while in the office of his previous employer firm. X argued at the hearing that the Purposed Supervisor will be able to properly supervise his computer activities from an off-site location by utilizing a monitoring program. We are not persuaded, however, that such a plan will be sufficient to supervise X, who has previously demonstrated how irresponsible he can be in using office computers, since he used his computer at Firm One to commit a crime by accessing and storing child pornography.

We also question whether the Purposed Supervisor has sufficient time to devote to the heightened supervision of a statutorily disqualified individual such as X. The Proposed

Supervisor testified that he is a producing manager who is already directly supervising 14 registered representatives throughout a large geographic area. Although the Proposed Supervisor testified that he feels capable of adding X to his list of persons he supervises, he has never supervised a statutorily disqualified individual before and is unaware of the responsibility for properly monitoring the activities of such a person. Moreover, the Proposed Supervisor testified that he expected the Sponsoring Firm to provide him with overrides on X's production. We believe that it creates a potential for conflict when a supervisor benefits directly from the production of a statutorily disqualified individual. We are also concerned that the Proposed Supervisor has not yet reached an agreement to satisfy his tax liens from 1997 and 2002.

For these reasons, we conclude that under the proffered supervisory plan, the Sponsoring Firm and the Proposed Supervisor are unable to provide the required heightened level of supervision necessary to assure us that they will effectively prevent and detect possible misconduct on the part of X.

VII. Conclusion

Accordingly, we find that it is not in the public interest, and would create an unreasonable risk of harm to the market or investors, for X to associate with the Sponsoring Firm as a general securities representative. We therefore deny the Application.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith
Senior Vice President and Corporate Secretary