

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 19(d)
Securities Exchange Act
of 1934
SD00003

On February 7, 2000, a member firm ("the Sponsoring Firm" or "the Firm") submitted an MC-400 application ("Application") to NASD Regulation, Inc. ("NASD Regulation") to permit X¹, a person subject to statutory disqualification, to associate with the Firm as a general securities representative. In March 2000, a subcommittee of the Statutory Disqualification Committee of NASD Regulation held a hearing on the matter. X appeared and was accompanied by his proposed supervisor ("the Proposed Supervisor"), and the Firm's Regional Compliance Officer. BA appeared on behalf of the Department of Member Regulation ("Member Regulation") of NASD Regulation.

X's Statutory Disqualification and Background. X is subject to a statutory disqualification due to a 1998 order ("Order") of the Commodity Futures Trading Commission ("CFTC"). The Order was based on an offer of settlement in which X consented to findings that he aided and abetted violations of the antifraud provisions of Sections 4b(a), 4o(1)(a) and 4o(1)(b) of the Commodity Exchange Act ("the Act"), and that he was liable for such violations as a controlling person under Section 13(a) of the Act²

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 The Order found that X controlled two companies, Companies A and B, which provided agricultural marketing consulting and advisory services to agricultural producers. The Order stated that X negotiated the contractual arrangements for Companies A and B to provide consultants with training and assistance in promoting certain misleading trading strategies in hedge to arrive contracts

The CFTC ordered X to cease and desist from future violations of the Act and to pay a \$10,000 monetary penalty. The CFTC also ordered X to comply with the following undertaking: "For a period of three years from the date of [the] Order, X shall not apply for registration with the [CFTC] in any capacity and shall not engage in any activity requiring such registration or act as an agent or officer of any person registered or required to be registered with the [CFTC]."

Section 3(a)(39) of the Securities Exchange Act of 1934 and Article III, Section 4 of the NASD By-Laws state that a person is subject to disqualification if, among other things, the person is subject to a CFTC order "denying, suspending, or revoking" such person's registration under the Commodity Exchange Act. When X entered into the offer of settlement with the CFTC, he was no longer registered with the CFTC as a commodity trading advisor. He consented, however, to the undertaking that he would not apply for CFTC registration for a period of three years. As set forth below, this undertaking acts as the functional equivalent of a CFTC order "denying, suspending, or revoking" registration and subjects X to statutory disqualification.

The Commodity Exchange Act establishes a system of statutory disqualifications pursuant to which the CFTC may deny, condition, suspend, restrict or revoke registrations. Although the Act sets forth several specific offenses and circumstances constituting statutory disqualifications, Section 8a(3)(M) provides that the CFTC may refuse to register or register conditionally any person, if, after an opportunity for a hearing, the CFTC finds that there is "other good cause" for not registering the person. Such "other good cause" for disqualification exists when an individual fails to comply with an undertaking not to apply for registration with the CFTC in any capacity. The CFTC has interpreted Section 8a(3)(M) as follows: "The . . . attempt to register in the face of such an undertaking would indicate the lack of fair and honest dealing which the [CFTC] believes constitutes 'other good cause' for denying, revoking, or conditioning registration under the Act." The CFTC also has stated that "allowing such a person to be registered would be inappropriate and inconsistent with the intention of the parties to the prior settlement agreement." See Interpretative Statement With Respect to Section 8a (2)(C) and (E) and Section 8a (3) (J) and (M) of the Commodity Exchange Act, 17 C.F.R. Part 3 at App. A.; see also Letter dated September 28, 1999 from the Office of General Counsel, NASD Regulation, to X's counsel. Because the CFTC order effectively prohibits X from applying for registration with the CFTC during the three-year undertaking period,³ we find that it operates as the

("HTAs") that purported to be risk-free. The Order also stated that X was familiar with the companies' written materials and that he occasionally lectured at seminars that promoted the misleading strategies.

³ The CFTC notifies applicants who are subject to disqualification under Sections 8a(2) and 8a(3) of the Act that their registration may be denied based on the disqualification. See 17 C.F.R. 3.51, 3.60 (1999). If the applicant indicates that he still wants the application considered, the Division of Enforcement institutes denial proceedings, and upon the Division's demonstration of the grounds for disqualification, a prima facie case of unfitness is established. In re David Itzkowitz, 1995 CFTC LEXIS 188 (July 25, 1995). The burden then shifts to the applicant to overcome the presumption of unfitness by producing evidence that despite the statutory disqualification, his registration would pose no substantial threat to the investing public. Id.

functional equivalent of a CFTC order "denying, suspending, or revoking" registration under Article III, Section 4 of the NASD By-Laws.⁴

When X entered into the Offer of Settlement with the CFTC, and from October 1996 to June 1999, he was employed by Firm A as a general securities representative. He apparently informed personnel at Firm A of the CFTC order, but his Uniform Application For Securities Industry Registration or Transfer ("Form U-4") was not amended to disclose the existence of the Order in a timely fashion. In June of 1999, Firm A filed a Uniform Termination Notice For Securities Industry Registration ("Form U-5") terminating X due to the statutory disqualification.

The Sponsoring Firm. The Sponsoring Firm became a member of the Association in 1974. The Firm has 656 Offices of Supervisory Jurisdiction ("OSJs"), and 896 branch offices, and it employs 1,902 general securities representatives. The Firm conducts a general securities business and has various investment advisor, insurance, and brokerage affiliates. One of these affiliates was Firm B, a wholly-owned subsidiary broker-dealer which later merged with Firm D, another wholly-owned subsidiary broker-dealer, to become the Sponsoring Firm. Firm B has been the subject of three state disciplinary actions and one NASD disciplinary action.⁵ In July 1997, the NASD issued a decision finding that Firm B's supervisory procedures were not reasonably designed to detect the mutual fund switching activities of a registered representative in a branch office. The NASD imposed a censure, a \$10,000 fine, and required the Firm to submit satisfactory written supervisory procedures to the staff of the NASD District office in which the Firm was domiciled.

The Sponsoring Firm's 1999 routine examination and off-cycle municipal examination were filed

⁴ We recognize that the CFTC order states: "[X] does not consent to the use of his Offer or this Order, or the findings consented to in this Order, by any other person or entity in this or any other proceeding. The findings made in this Order are not binding on any other person or entity named as a defendant or respondent in this or any other proceeding." We find, however, that despite this language, it is the NASD's own responsibility to determine whether an individual should be denied NASD membership under the NASD's By-Laws based on a statutory disqualification. Cf. New York Mercantile Exchange v. CFTC, 828 F. Supp. 186 (S.D.N.Y. 1993) (rejecting CFTC motion to dismiss in New York Mercantile Exchange ("NYMEX") denial-of-membership action, and finding CFTC consent order stating that it may not be used as "sole basis" for any other proceeding contrary to NYMEX's duty to regulate its own membership).

⁵ In 1998, State 1 Securities Commission imposed a \$1,000 fine on Firm B for employing an unlicensed investment advisor. In 1997, Firm B entered into a Consent Order with State 2 for offering unregistered investments in the State and was fined \$2,000. In 1994, Firm B entered into an Offer of Settlement with State 3 agreeing, among other things, to offer rescission to State 3 investors for the sale of unregistered bonds, and to implement and maintain procedures designed to ensure compliance with State 3 law.

without action. The Firm employs one individual who is statutorily disqualified due to a conviction for conspiracy to possess marijuana.

The Proposed Supervisor and X's Proposed Duties. The Sponsoring Firm proposes to employ X as a general securities representative primarily engaged in sales of mutual funds, variable annuities, and certificates of deposit ("CD"). X would be employed as an independent contractor and located in a branch office (an Office of Supervisory Jurisdiction).

X's proposed supervisor, is manager of the branch office where X would be employed. X and the Proposed Supervisor would be the only registered representatives located in that office. The Proposed Supervisor has been a registered representative since 1992 and a principal since 1999. The Proposed Supervisor became associated with the Sponsoring Firm in 1999, and previously was employed by Firm A from 1992 to 1999.

The Proposed Supervisor has no disciplinary history, but he reported on his Form U-4 one customer complaint that resulted in no further action. The customer claimed to have requested that the Branch Manager purchase a CD with a one-year rather than an 11-year maturity date. Firm A credited the Proposed Supervisor's version of events after noting that the customer had received a confirmation reporting the maturity date several months earlier but had not complained to the Sponsoring Firm until after the customer sold the CD for a loss.

Member Regulation's Recommendation. Member Regulation recommends that X's association with the Sponsoring Firm be denied. First, Member Regulation notes that underlying the CFTC's order is the presumption that X is unfit to be associated in the commodities industry until the three-year undertaking has concluded. Member Regulation notes that X's disqualification was relatively recent and involved misrepresentation, a fact bearing on X's fitness to be in the securities industry.

Member Regulation also finds the proposed supervision inadequate due to the Proposed Supervisor's lack of supervisory experience and because he has been a general securities principal since only December of 1999. In addition, Member Regulation noted concern over the Sponsoring Firm's disciplinary history, which includes employing an unlicensed individual acting in a registered capacity, offering and selling unregistered securities, and maintaining inadequate written supervisory procedures.

Finally, Member Regulation recommends that the Application be denied due to X's failure to update his Form U-4 to report the CFTC order. Member Regulation notes that the instructions on the Form U-4 are clear -- they state in relevant part that "an applicant is under a continuing obligation to update information required by Form U-4 as changes occur." The Form U-4 also requires the individual to certify that he agrees to amend the form on a "timely basis." Question 22D(4) of the Form U-4 asks, in relevant part: "Has . . . the Commodities Futures Trading Commission ever: entered an order against you in connection with investment-related activity?" Member Regulation notes that X failed to amend his Form U-4 for approximately nine months, from September 1998 to June of 1999.

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 denied.

In reaching this conclusion, we defer to the CFTC's determination that X should not be registered or engaged in activity requiring registration in the commodities industry for a period of three years. We think it would not be appropriate for X to be engaged in investment-related activity in the securities industry during the effective period of the undertaking. If we were to conclude otherwise, absent extraordinary circumstances, we effectively would be frustrating the remedial purpose underlying the CFTC's Order imposing sanctions.⁶

The three-year undertaking is the primary basis for our denial. We also agree with Member Regulation that the proposed supervision is inadequate, especially given the heightened supervision required of statutorily disqualified individuals. The Proposed Supervisor, has only recently become a principal (in 1999) and has no prior experience supervising registered representatives. We also note that although the Sponsoring Firm is a well-established firm and appears to have an extensive supervisory structure as outlined in the Firm's manual submitted as part of this proceeding, the Firm has failed to show that X would be appropriately supervised as an independent contractor located in a branch office. Apparently, only X and the Proposed Supervisor would be located in that office. The Proposed Supervisor joined the Firm only in 1999. We think the proposed supervision of a statutorily disqualified individual in a branch office by a supervisor who not only is new to the Firm, but also has no previous supervisory experience in the securities industry, is cause for concern.

Finally, like Member Regulation, we also are concerned by X's failure to amend his Form U-4 to report the CFTC order. See, e.g., In re Rosario Ruggiero, 52 S.E.C 725, 728 (1996) ("[L]ate amendment of a Form U-4 may be grounds for denying a statutorily disqualified person [association] with a member."). X maintains that he notified Firm A's personnel of the CFTC's actions and relied on their judgment as to what forms to fill out. X also produced documentation at the hearing as evidence of his communications with Firm A's personnel in this regard. We note that he apparently did disclose the existence of the CFTC's order to Firm A's personnel, as this disclosure ultimately caused Firm A to terminate his employment due to his statutory disqualification. We emphasize, however, that it is an individual representative's responsibility to ensure compliance with NASD requirements, including amendments to Forms U-4. See, e.g., In re Thomas C. Kocherhans, 51 S.E.C. 528, 531 (1995) (registered representatives cannot shift responsibility for compliance with regulatory requirements to

⁶ We reject X's attempts to attack collaterally the CFTC's order by arguing that his partner ran the HTA program, that he (X) never lectured on the HTA contracts, and that he did not prepare the misleading written materials. Applicant was advised at the hearing, both in the opening statement and by the hearing panelists, that no evidence seeking collaterally to attack the findings that resulted in the statutory disqualification would be permitted. Such collateral attacks are not properly considered in these eligibility proceedings. See In re Jan Biesiadecki, Exchange Act Rel. No. 39113 (Sept. 22, 1997); In re Michael B. Scheft, 48 S.E.C. 710, 712 (1987).

firms).

We reiterate that the primary basis for our denial is X's prohibited registration with the CFTC until 2001. We were impressed with X's demeanor and sincerity at the hearing and with the Proposed Supervisor's ardent support of X. We note that X may reapply for association with a member firm if he so chooses in the future.⁷ At this time, however, we find that denial of the application would be in the public interest.

Accordingly, we conclude that the Sponsoring Firm' Application to employ X as a general securities representative should be denied.

On Behalf of the National Adjudicatory Council,

Joan C. Conley
Senior Vice President and Corporate Secretary

⁷ Because X's undertaking has the effect of barring him from the commodities industry with a right to reapply after three years, X will remain subject to our statutory disqualification process even after the three-year period has expired.