

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

SD99002

On May 29, 1998, the Sponsoring Firm submitted an MC-400 application ("Application") to permit X¹, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as a general securities representative.² In October 1998, a subcommittee of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by counsel and his proposed supervisor ("the Proposed Supervisor"). BDK and JSH appeared on behalf of the Department of Member Regulation ("Member Regulation").

X is subject to a statutory disqualification as a result of 1991 guilty plea to a felony charge brought by the District Court in State 1, for the criminal sale of a controlled substance, cocaine. For this misconduct, X was incarcerated for 60 days and placed on five years' probation. He was discharged early from probation in 1994.

Since the events surrounding his disqualification, X has applied for and received approval to return to the securities industry. In 1994, Firm A filed an application for X to become associated with that firm as a registered representative. The NASD Board of Governors denied this application in 1994. X appealed the NASD's decision to the Securities and Exchange Commission ("SEC" or "the Commission"), which ordered the NASD to permit X's association with any member firm. The

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 Application was amended on August 25, 1998 to reflect a change in the proposed supervisor for X.

Commission stated that the specific felony offense which led to X's conviction was not enumerated in the former version of the NASD's By-Laws, and therefore the NASD could not prohibit the proposed association.³

In 1996, the NASD Board of Governors approved an application filed by Firm B for X to become associated as a registered representative. The approval of Firm B's application was contingent upon supervision of X by two general securities principals, including: 1) a review of all new account forms and order tickets on a daily basis; 2) a review of all outgoing correspondence; and 3) physical proximity of the supervisors to X. X resigned from Firm B in 1997.⁴

The Sponsoring Firm has been a member of the NASD since 1995 and it is engaged in a general securities business, primarily retail agency. The Sponsoring Firm clears on a fully disclosed basis and employs 23 individuals, of whom five are registered principals and eight are registered representatives. The Sponsoring Firm has only one office, which is an Office of Supervisory Jurisdiction ("OSJ") where X will work, located in New York.

The Sponsoring Firm proposes to have X supervised by the Proposed Supervisor, who has been the Sponsoring Firm's Compliance Officer since 1998. The Proposed Supervisor has been a

³ In November 1990, Congress expanded the definition of statutory disqualification under Section 3(a)(39)(F) of the Securities and Exchange Act of 1934 ("the Exchange Act") to include convictions of any felony within 10 years of filing an application to be associated with a member of a self-regulatory organization. The NASD did not incorporate this amendment into its By-Laws, however, until November 1995. See In re Patrick J. O'Connor, Exchange Act Rel. No. 35857 (June 19, 1995). At the time of X's application to associate with Firm A, the specified categories of conduct were: (1) "The purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense"; (2) "the conduct of the business of a broker, dealer, municipal securities dealer or government securities broker or dealer, investment adviser, bank, insurance company, fiduciary, or any entity or person required to be registered under the Commodity Exchange Act"; (3) "the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities"; or (4) "the violation of Sections 152, 1341, 1342, or 1343 or Chapters 25 or 47 of Title 18, United States Code." NASD By-Laws, Article II, Section 4(f) (1994).

In 1995, the NASD revised its By-Laws to provide that the NASD has the authority to deny an individual permission to become associated with a member if he or she "has been convicted within ten years preceding the filing of any application . . . to become associated with a member of the Corporation, . . . of any felony." Exchange Act Rel. No. 36466 (Nov. 8, 1995) (emphasis added). X is therefore subject to a statutory disqualification under this version of the NASD By-Laws, which is in effect during the consideration of this Application. See In re Eli Boggs Combs, Exchange Act Rel. No. 37075 (Apr. 5, 1996) (Commission held that NASD By-Laws in effect during the consideration of an application are controlling).

⁴ X testified that he left Firm A because he was not "happy with" that firm's sales practices or stock performance.

general securities principal since 1993 and a financial and operations principal since 1998. He has no disciplinary history.

The Sponsoring Firm formerly did business as Firm C (1995 through 1998).⁵ Firm C's prior home office, located in Texas, closed in 1997, following Firm C's entry into a consent agreement with the Texas State Securities Board that imposed a \$30,000 fine, a formal reprimand, a suspension for one day from soliciting new accounts, and a requirement to employ an independent consultant to submit a report within 90 days setting forth revisions in Firm C's compliance system. The Texas action included charges of permitting unregistered persons to act as agents, failure to comply with a 1996 NASD Regulation Letter of Caution,⁶ margin rule violations, books and records violations, and failure to supervise. Since that time, Firm C has had a complete change of management and determined to close the Texas office and maintain its sole office in New York, which office is now doing business as the Sponsoring Firm.

Discussion

Member Regulation objects to X's association with the Sponsoring Firm based on: 1) the serious nature of the activity that led to X's statutory disqualification; 2) a perception of recurrent problems by X with substance abuse; 3) a customer complaint against X and a pending arbitration action against Firm B, which names several individuals, including X; and 4) concerns about the Sponsoring Firm's net capital and compliance issues, including the Texas State Securities Board action against Firm C in 1997. Based on these reasons, Member Regulation suggests that it is not in the public interest to allow X to associate with the Sponsoring Firm. After carefully considering these arguments and the record, however, we conclude that the Application should be approved.

Although X's violation was serious, it no longer provides a basis for precluding his association with a member firm. In the years since it occurred, X has committed no other violations, and the NASD has permitted X to associate previously with Firm B.⁷ The customer complaint against X cited by Member Regulation was received by Firm B after he left that firm. This complaint was investigated by NASD District No. 10 and it was closed without any action being taken. The same customer later filed an NASD arbitration claim against Firm B, without naming X as a respondent. The other complaint

⁵ At the hearing on this Application, the Proposed Supervisor testified that, legally, a complete name change had not been effected but that the Sponsoring Firm was operating as Firm C because a firm with a similar name in Boston had requested that the Sponsoring Firm stop doing business under the Firm C name to avoid confusion.

⁶ The 1996 NASD Regulation Letter of Caution focused on books and records, customer account information, and suitable recommendations to customers.

⁷ We do not share Member Regulation's concern that X has demonstrated a pattern of substance abuse. Since the 1991 felony conviction, X was arrested and pled guilty once, in 1995, to a misdemeanor of operating a motor vehicle while impaired by alcohol. Afterward, he successfully completed both a state driving program and an Alcoholism Education Series. X stated at the hearing that he does not drink or use drugs at all.

cited as a concern by Member Regulation is a pending arbitration claim against Firm B and several individuals, including X. He testified that he handled the account in question for a limited period of time, after which it was reassigned by Firm B to another representative in an effort to obtain more production. NASD Regulation has not investigated that matter.

As to Member Regulation's concern with the capitalization of the Sponsoring Firm, we note that the Firm is currently in capital compliance.⁸ The 1998 routine examination of the Sponsoring Firm remains pending, as does a 1998 NASD District No. 10 special financial and operations examination of the Sponsoring Firm. The Sponsoring Firm has filed with the SEC a request for a "no action" letter regarding one of the issues raised during those examinations C the marketability of certain securities and thus their inclusion as allowable assets subject to haircut. As previously noted, the 1996 routine examination of the Sponsoring Firm resulted in a Letter of Caution, which was mentioned in the action brought by the Texas State Securities Board. As stated previously, the management of the Sponsoring Firm has completely changed and the Sponsoring Firm has relocated from Texas to New York.

We conclude that the Sponsoring Firm and are qualified to supervise X and they have proposed an effective plan of supervision:

- (1) X and the Proposed Supervisor will be located in close proximity in the Sponsoring Firm's home office;
- (2) The Proposed Supervisor will regularly monitor X's telephone calls and presentations to customers; and
- (3) The Proposed Supervisor will personally monitor and review X's correspondence, new accounts, and order tickets prior to entry.

The Sponsoring Firm employs no other individuals who are subject to statutory disqualification.

⁸ Post-hearing submissions show that in the course of the Sponsoring Firm's annual audit for, 1998, it was determined by the Sponsoring Firm's accountants that certain liabilities had not been properly accrued on the Sponsoring Firm's financial records and that, as a result, the Sponsoring Firm was not in compliance with the Net Capital Rule on a date in 1998. An SEC Rule 17a-11 notification to this effect was sent to the NASD later in 1998.

At the request of the NASD Regulation District 10 staff in New York, the Sponsoring Firm recomputed its net capital for each month's end during 1998. This reflected that, even after the adjustments required to reflect the accruals, the Sponsoring Firm was in capital compliance at every month's end except for one (which had been the subject of the notification). Indeed, with its 1998 capital infusion of \$200,000, the Sponsoring Firm indicated the following recomputed surplus net capital above its required net capital of \$100,000:

\$141,397 as of 1 month after the violation
 \$102,363 as of 2 months after the violation
 \$191,995 as of 3 months after the violation.

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 have represented that they 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 representative associated with the Sponsoring Firm will become effective within 30 days of the issuance of this decision unless otherwise notified by the Commission.

On Behalf of the National Adjudicatory Council

Joan C. Conley
Corporate Secretary