

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

In the Matter of  
the Association

of

X

as an

Investment Company and  
Variable Contracts Products Representative

with

The Sponsoring Firm

**Redacted Decision**

Notice Pursuant to  
Section 19h-1  
Securities Exchange Act  
of 1934

Decision No. SD990024

On March 22, 1999, a member firm ("the Sponsoring Firm" or "the Firm") submitted an MC-400 application ("Application") to permit X<sup>1</sup>, a person subject to a statutory disqualification, to associate with the Firm as an investment company and variable contracts products representative. In October 1999, a subcommittee ("Hearing Panel") of the Statutory Disqualification Committee ("SD Committee") of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by his counsel and by the President of the Sponsoring Firm and X's proposed supervisor ("Proposed Supervisor"). BA appeared on behalf of NASD Regulation's Department of Member Regulation ("Member Regulation").

Statutory Disqualification. X is subject to a statutory disqualification pursuant to Section 3(a)(39)(F) of the Securities Exchange Act of 1934 and Article III, Section 4(b) of the NASD By-Laws, due to a 1987 qualified bar imposed by an Administrative Law Judge ("ALJ") of the Securities and Exchange Commission ("SEC" or "the Commission"). The ALJ's order prohibited X from being associated with any broker or dealer in any capacity, with the proviso that he could apply to become associated after 18 months in a non-supervisory and non-proprietary capacity upon a satisfactory showing of adequate supervision. The ALJ found that in 1980 and 1981, X violated Section 17(a) of

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<sup>1</sup> 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.

the Securities Act of 1933 and Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, by making false representations and failing to disclose material information concerning the adverse financial conditions of an issuer to his customers. X petitioned the Commission for review of the ALJ's decision, and in 1989, the Commission sustained the ALJ's findings and sanctions. [Case Citation Redacted]. X appealed to a United States Court of Appeals, which affirmed the SEC's order [Case Citation Redacted].

**Prior Application.** The Sponsoring Firm has previously filed an MC-400 application to sponsor X's association with the Firm. In 1996, the Sponsoring Firm sought to employ X as an investment company and variable contracts products representative under the proposed supervision of the Sponsoring Firm's president. The NASD denied the application on December 16, 1996. The NASD found that the proposed supervisor did not have sufficient experience in the sale and supervision of variable products to supervise X adequately because the Proposed Supervisor primarily sold limited partnerships. The NASD noted that the Sponsoring Firm's business was comprised of only a small percentage of variable products and mutual funds sales. The NASD also stated that it was troubled by an inaccurate representation on X's Uniform Application for Securities Industry Registration or Transfer Form ("Form U-4"), which had been submitted in connection with the application. The Form U-4 incorrectly represented that in response to X's appeal requesting that the case be reopened to present new evidence, the Circuit Court had found that the new evidence, although time barred, would have "exonerated" him. The Circuit Court made no such finding.

X. X entered the securities industry as a registered representative in 1980. Since the SEC bar became final, he has lectured associated persons of broker/dealers on the advantages of portfolio diversification. He also has provided research and prepared publications relating to variable annuities and insurance products.<sup>2</sup> According to X's representations on the Form U-4 that was submitted in conjunction with this Application, in 1994, Firm A filed a Form U-4 to begin sponsoring X's association with the firm. In 1995, however, Firm A filed a Uniform Termination Notice of Securities Industry Registration ("Form U-5") and alleged that X had committed a "possible" violation. In connection with this Application, X disclosed on his Form U-4 that Firm A had placed him under internal review for allegedly receiving commissions for the sale of variable life annuities. X stated that he was responsible for the sale of fixed annuities and term insurance only, not variable annuities. The NASD opened a cause examination that was filed without action in 1996.

**The Sponsoring Firm.** The Sponsoring Firm has been a member of the Association since 1989. It has one office of supervisory jurisdiction and no branch offices, and it employs one registered principal and 11 registered representatives. The Sponsoring Firm is engaged in selling direct participation programs (limited partnerships), mutual funds, variable annuities, and variable life insurance products. A 1999 routine examination of the Sponsoring Firm is complete, but no results had been determined by the date of the hearing in this matter. Member Regulation knows of no complaints,

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<sup>2</sup> We reach no conclusion as to whether X's activities relating to variable annuity products required registration as a broker or dealer. We note that X's counsel indicated that he believed that X was not acting in a capacity that would have required such registration.

disciplinary proceedings, or arbitrations against the Sponsoring Firm. The Sponsoring Firm employs no statutorily disqualified individuals.

The Sponsoring Firm proposes to employ X as an investment company and variable contracts products representative located in the home office. The Sponsoring Firm represents that X's primary activities would be selling variable annuities and other life insurance products to sophisticated investors. He also would sell investment company securities and variable contracts products, but not sell debt or equity securities. He would be compensated on a commission basis, and would not act in a supervisory or proprietary capacity.

The Sponsoring Firm proposes that Firm's president would be responsible for X's supervision. The Proposed Supervisor has been an investment company and variable contracts products representative since 1983 and a general securities principal since 1990. Member Regulation knows of no disciplinary proceedings, complaints, or arbitrations against the Proposed Supervisor.

Member Regulation's Recommendation. Member Regulation recommends that X's association with the Sponsoring Firm be denied. In reaching this determination, Member Regulation focused on whether the Proposed Supervisor had attained additional experience in the sale and supervision of the sale of variable products since the NASD's denial of the prior application. Based on submissions from the Sponsoring Firm in response to questions about the Firm's business, Member Regulation stated that it was not convinced that the 1996 application was materially different from the present Application. Member Regulation also stated that although the Proposed Supervisor has been supervising two registered representatives who have sold variable products over the last three years, the Sponsoring Firm failed to provide information regarding the volume or size of these transactions. Member Regulation therefore concluded that the Proposed Supervisor's "hands-on" supervisory experience with respect to variable annuities was "quite limited."

### Discussion

After a careful review of the entire record in this matter, we conclude that X should be permitted association as an investment company and variable contracts products representative with the Sponsoring Firm.

In reaching this determination, we have considered that in 1987, when the SEC imposed the bar on X, with the right to reapply after 18 months, the Commission was charged with weighing the requirements of the public interest in light of X's misconduct. The Commission concluded that it was appropriate to allow X to apply for association with a broker/dealer after 18 months in a non-supervisory and a non-proprietary capacity. Accordingly, in reviewing this Application, NASD Regulation must follow the guidance supplied by the SEC in In re Paul Van Dusen, 47 S.E.C. 668 (1981). Van Dusen tells us that, in Commission enforcement actions in which a right to reapply is specified, an application submitted after the specified term should be granted, absent other acts of misconduct or circumstances of record bearing adversely on a firm or a sponsored person's fitness to re-enter the securities industry. In order to deny approval where a right to reapply has been granted,

the NASD is prohibited from considering any factors apart from "other [intervening] misconduct in which the applicant may have engaged, the nature and disciplinary history of a prospective employer, and the supervision to be accorded the applicant." Van Dusen, at 671.

Member Regulation recommends that the Application be denied based on the Van Dusen factor relating to the proposed supervision. Member Regulation's recommendation states that although the Sponsoring Firm represented that it has \$23,000,000 worth of variable sales agreements under its management, only five clients appear to have portfolios that include variable annuities. Member Regulation asserts that the Sponsoring Firm failed to provide a breakdown of the number of transactions (including copies of account statements), the money involved in these transactions, or the nature of the Proposed Supervisor's supervision over these transactions. Member Regulation therefore concluded that the Proposed Supervisor's "hands-on" supervisory experience with respect to variable annuities appeared "quite limited."

The Sponsoring Firm represents that the Firm's "business mixture" has changed significantly since the last application when variable products and mutual funds comprised only "a small percentage" of the Firm's business. The Sponsoring Firm currently has variable sales agreements with six different insurance companies and 10 different mutual fund companies. The Proposed Supervisor has more than \$23,000,000 worth of these products under his supervision, comprising over \$10,000,000 in mutual funds and over \$13,000,000 in self-directed Individual Retirement Accounts.

We find that the record indicates that the Proposed Supervisor and the Sponsoring Firm have gained sufficient experience in variable annuities sales. Since the 1996 application, the Proposed Supervisor has been approved to teach two variable life and annuity continuing education classes to financial services professionals. The Proposed Supervisor also is currently supervising two representatives who have been selling variable products over the last three years. Although the Sponsoring Firm apparently did not provide the information specified by Member Regulation as noted above, we find that the record otherwise contains adequate information for us to assess the Proposed Supervisor's experience and the adequacy of the Firm's proposed supervision. We note that the Proposed Supervisor represented at the hearing on this matter that the Sponsoring Firm handles approximately one variable annuity transaction per day. The Proposed Supervisor explained that given the Sponsoring Firm's view that variable annuities are appropriate investment vehicles only for certain types of customers, the Firm's volume of such transactions generally would not be high.

Although the Proposed Supervisor apparently supervises only one variable annuity transaction per day, we conclude that he has sufficient knowledge to supervise the sale of variable annuity products, given his knowledge of variable annuities and other special products through his teaching and his activity in the insurance industry. Since 1996, the Proposed Supervisor also has personally sold more than 30 variable products representing more than \$8,000,000 in value. We find that the Proposed Supervisor's knowledge of variable products, in conjunction with the supervisory procedures outlined below, will ensure sufficient supervision of X. These supervisory procedures are intended to address suitability issues, churning through abusive annuity replacements or rollovers, and potential violations related to sales materials used in connection with the sale of variable annuities. See generally NASD Notice to

Members 99-35 (May 1999) (reminding members of their responsibilities regarding sales of variable annuities).<sup>3</sup>

Given the terms of the Commission's 1987 qualified bar, we have determined that under the requirements of the Commission's decision in Van Dusen, the Sponsoring Firm's Application satisfies the conditions necessary for X to re-enter the securities industry.

Our recommendation is based upon the following plan for supervision of X, which has been agreed to by the Sponsoring Firm and Member Regulation:

1. The supervisory procedures of the Sponsoring Firm will be amended to establish clearly that the Proposed Supervisor is X's only supervisor;
2. X will conduct securities business on behalf of the Sponsoring Firm only from the main office of the Firm in close proximity to the Proposed Supervisor;
3. X's primary duties will be selling variable annuities and other like insurance products;
4. X will have no supervisory functions at, or proprietary interest in, the Sponsoring Firm;
5. X will not maintain discretionary accounts;
6. The Proposed Supervisor will keep a written record evidencing review and approval of all of X's new account forms for suitability;
7. The Proposed Supervisor will keep a written record evidencing review and approval of X's order tickets prior to their execution;
8. The Proposed Supervisor will keep a written record evidencing review and approval of X's incoming and outgoing correspondence;
9. The Proposed Supervisor will keep a written record evidencing review and approval of all of X's sales materials;

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<sup>3</sup> We consider X's inaccurate representation on his 1996 Form U-4 no longer to be a factor that would cause us to deny this Application. At the hearing on this matter, X informed the Hearing Panel that the Form U-4 had been prepared by Sponsoring Firm personnel, but that he took "full responsibility" for the inaccurate statement. We also note that at the time of its initial submission attached to the Form U-4 was a copy of the full text of the Circuit Court's decision. Applicant has provided a corrected Form U-4 in connection with this matter.

10. The Proposed Supervisor will review and approve all of X's sales presentations and, on a random basis, will attend sales presentations made by X. The sales presentations will be made by tape recording or audio-visual recording that has been pre-approved by the Proposed Supervisor;<sup>4</sup>
11. The Proposed Supervisor will keep a written record evidencing review and approval of all of X's source documentation in connection with any research reports prepared by X;
12. The Proposed Supervisor will keep a written record evidencing that he has periodically contacted X's customers to verify suitability and customer satisfaction with X's recommended products and sales practices;
13. The Sponsoring Firm will tape-record all of X's telephone conversations for one year, and the Proposed Supervisor will review the tape recordings and maintain a record of his review;
14. 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;
15. The Proposed Supervisor will meet with X on a quarterly basis to review his transactions with clients and the distribution of customer funds. A log shall be kept by the Sponsoring Firm of these meetings;
16. All customer complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review. The Proposed Supervisor will prepare a memorandum to the file detailing the specific 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 will be kept segregated for ease of review;
17. 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;
18. The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) in a memo to a file that the Sponsoring Firm is in compliance with all of the above conditions of heightened supervision of X;
19. For the duration of X's statutory disqualification, the Sponsoring Firm must obtain prior approval from Member Regulation if it wishes to change X's supervisor from the Proposed Supervisor to another person.

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<sup>4</sup> Although the requirement that X's sales presentations be pre-recorded and pre-approved was not outlined in Member Regulation's letter, the Sponsoring Firm agreed to this condition at the hearing on this matter.

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 association of X as an investment company and variable contracts products representative with the Sponsoring Firm will become effective upon 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 shall serve as an application for such order.

On Behalf of the National Adjudicatory Council,

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Alden Adkins, Senior Vice President and General Counsel