BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Continued Association of X as an Investment Company/Variable Contracts Representative with The Sponsoring Firm	**REDACTED DECISION** Notice Pursuant to Rule 19d-1 Securities Exchange Act of 1934 SD Decision No. 04017

On December 18, 2003, the Sponsoring Firm[1] ("the Firm") completed a Membership Continuance Application ("MC-400" or "the Application") seeking to permit X, a person alleged to be subject to a statutory disqualification, to continue to associate with the Sponsoring Firm as an investment company/variable contracts representative. In July 2004, a subcommittee ("Hearing Panel") of NASD's Statutory Disqualification Committee held a hearing on the matter. X appeared in person at the hearing, accompanied by his proposed supervisor. LL and KA appeared on behalf of NASD's Department of Member Regulation ("Member Regulation").

For the reasons explained below, we conclude that, based on the unique facts and circumstances of this case, X is not currently subject to a statutory disqualification.

A. X's Alleged Statutorily Disqualifying Event

Member Regulation contends that X is statutorily disqualified because in March 2003, he was convicted of a felony in the state of Massachusetts for indecent assault and battery on a person over 14. X did not enter a formal guilty plea to this offense; instead, pursuant to Massachusetts law, the judge continued the matter without a finding ("CWOF") after X had admitted to the court sufficient facts for a guilty finding to be entered. The judge ordered X to undergo three years' supervised release, to have no contact with the victim, and to participate in sex offender counseling. X will be on supervised release until March 2006. According to

[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.

Massachusetts law, if X completes this period of supervised release without incident, the felony charge against him will be dismissed.

B. Background Information

X

X was first registered in the securities industry as an investment company/variable contracts representative (Series 6) and a uniform securities agent (Series 63) in June 1988. He later qualified as an investment advisers law agent (Series 65) in May 1999. X has been associated with the Sponsoring Firm since December 1995.[2]

C. Discussion

In a letter dated November 2003, NASD's Department of Registration and Disclosure ("Registration and Disclosure") first informed X that he was subject to a statutory disqualification.[3] This letter stated that the Sponsoring Firm must promptly submit an MC-400 application or NASD would revoke X's registration without further notice. Member Regulation maintains that X is statutorily disqualified because he has been convicted of a felony. The Sponsoring Firm argues that X has not been convicted of a felony and therefore it should not have been required to submit an MC-400 application for X to undergo NASD eligibility proceedings. Accordingly, this issue is before us for decision.

1. Federal Statutory Provisions and NASD By-Laws

In order to determine whether X is statutorily disqualified, we first turn to the language of the controlling statutory provisions and NASD's By-Laws.

Pursuant to Section 15A(g)(2) of the Securities Exchange Act of 1934 ("the Exchange Act"), and NASD By-Laws Art. III, Sec. 3(d), a person subject to statutory disqualification is ineligible to associate with a member firm unless he or she obtains special relief from NASD through the eligibility process outlined in Procedural Rules 9520 et seq.

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[2] X was previously employed by Firm 1 from April 1988 until December 1995.

[3] At the hearing, X testified that he informed the Sponsoring Firm promptly of the felony charge and the court's action in March 2003. The Sponsoring Firm did not update X's Uniform Application for Securities Industry Registration or Transfer ("Form U4"), however, until September 2003, when X sought to amend his Form U4 to add an additional state registration. Registration and Disclosure therefore was not aware of the criminal charge against X until the Firm filed the amended Form U4.

There are various categories of statutory disqualification. Here, Member Regulation contends that X is statutorily disqualified pursuant to Exchange Act, Section 3(a)(39),[4] which states that:

> A person is subject to a 'statutory disqualification' with respect to membership or participation in, or association with a member of, a self-regulatory organization, if such person:
> . . . .
>
> (F) . . . has been convicted of . . . any . . . felony within 10 years of the date of the filing of an application for membership or participation in, or to become associated with a member of, such self-regulatory organization . . .

2. Interpretative Letters From the Securities and Exchange Commission

The record is clear that X was charged with a felony. The question is whether he was convicted on the felony charge. The term "convicted" is not defined in either the Exchange Act, or NASD's By-Laws. The Securities and Exchange Commission has advised NASD to look first to federal securities laws for guidance on this issue and therefore instructed NASD to turn to the Investment Company Act of 1940 ("Investment Company Act"), Section 2(a)(10) and the Investment Advisers Act of 1940 ("Advisers Act"), Section 202(a)(6), which define "convicted" to include: "a verdict, judgment or plea of guilty, or a finding of guilt on a plea of nolo contendere, if such verdict, judgment, plea or finding has not been reversed, set aside, or withdrawn, whether or not sentence has been imposed." Interpretative letter dated February 21, 1992, from Joseph M. Furey, Assistant Director, Division of Market Regulation, SEC, to Bruno Lederer, Associate General Counsel, NYSE ("the Lederer Letter") (copy attached).

The Commission used this definition in the Lederer Letter to provide interpretative guidance for three situations in which state law raised uncertainty as to whether a conviction exists, including criminal cases in which a finding of guilt is held in abeyance pending the satisfactory completion of probation. The question addressed by the SEC at that time was whether an individual is convicted when he or she pleads guilty or nolo contendere and a judge then defers judgment and places the person on probation. In considering this situation, the SEC used a Maryland statute as an example and determined that a person is convicted for purposes of Section 3(a)(39) of the Exchange Act if a judge defers judgment and puts a defendant on probation after the judge either finds the defendant guilty or "accepts" a plea of nolo contendere. The SEC stated that such an individual would remain convicted until the probation is successfully completed and the charges are dismissed.

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[4] Art. III, Sec. 4 (g)(1) of NASD's By-Laws also contains a similar definition of statutory disqualification.

The Lederer Letter did not address a situation such as X's, where the court did not accept a plea of guilty, but rather followed the Massachusetts procedure known as CWOF – continued without a finding of guilt. The Commission did address a similar situation, however, in a November 9, 2000 letter to the NYSE. Interpretative letter dated November 9, 2000, from Catherine McGuire, Chief Counsel, Division of Market Regulation, SEC, to Peggy Germino, Manager, NYSE ("the Germino Letter") (copy attached). In the Germino Letter, the Commission analyzed a California statute that permitted first-time drug offenders to have the option of pleading guilty, and then have the judge "defer" the entry of judgment. If the California defendant successfully completed the ordered treatment or program, then the court dismissed the criminal charges against the defendant. The Commission determined that, pursuant to the terms of this California statute, the court did not make a finding of guilt or accept a plea of guilty. Accordingly, the SEC concluded that the judge effectively "set aside" the plea pending the outcome of the probationary period and the defendant had not been convicted.

For the reasons set forth below, we conclude that the Massachusetts statute at issue here is similar to the California statute considered by the SEC in the Germino Letter, and therefore we find that X has not been convicted of a felony and is not subject to a statutory disqualification.

3. Massachusetts Law

Massachusetts General Laws Ch. 278, Sec. 18 (2004) ("Section 18") provides, in pertinent part:

> A defendant who is before the Boston municipal court or the district court on a criminal offense within the court's final disposition shall plead guilty or not guilty, or with the consent of the court, nolo contendere. Such plea of guilty shall be submitted by the defendant and acted upon by the court; provided, however, that a defendant with whom the commonwealth cannot reach agreement for a recommended disposition shall be allowed to tender a plea together with a request for a specific disposition. Such request may include any disposition or dispositional terms within the court's jurisdiction, including, unless otherwise prohibited by law, a dispositional request that a guilty finding not be entered, but rather the case be continued without a finding to a specific date thereupon to be dismissed, such continuance conditioned upon compliance with specific terms and conditions or that the defendant be placed on probation pursuant to the provisions of section eighty-seven of chapter two hundred and seventy-six . . . .

Although we look ultimately to the federal securities laws for guidance in interpreting the question of when a defendant has been convicted of a felony, the SEC has stated that a state's interpretation of its laws may be instructive, if not controlling. With this in mind, we note that the Massachusetts courts have stated that Section 18 allows a defendant to offer a "plea of guilty, together with a request that a guilty finding not be entered and that the case be continued without the entry of such a finding on specific terms or on probation." Commonwealth v. Jackson, 45

Mass. App. Ct. 666, 670 (1998) (quoting Commonwealth v. Pyles, 423 Mass. 717, 721 (1996)). In accordance with Section 18, X did not plead guilty to the offense alleged, but merely tendered a plea that there were sufficient facts alleged to support the allegations against him. Thus the judge did not accept a guilty plea from X, nor enter a finding of guilty against X. As the Massachusetts courts have stated: "A plea of guilty tendered pursuant to [Section 18] is not the entry of a formal guilty plea and is, therefore, not a conviction." Jackson, 45 Mass. App. Ct. at 670. See also Commonwealth v. Villalobos, 437 Mass. 797, 802 (2002) ("An admission to sufficient facts followed by a continuance without a finding is not a 'conviction' under Massachusetts law.").

Massachusetts courts have interpreted this provision as being similar to a pretrial diversion program: "Section 18 represents the delineation by the Legislature of a dispositional option, similar to that offered by a pretrial diversion program." Pyles, 423 Mass. 717, 722 (1996). Pretrial diversion, if successful, avoids having the court enter a conviction as "[t]he very purpose of a pretrial diversion program is to save a deserving defendant from the 'consequences of having a criminal conviction on his record.'" Jackson, 45 Mass. App. Ct. at 670 (quoting Commonwealth v. Duquette, 386 Mass. 834, 843 (1982) (superseded by Section 18)). Thus, because of its similarity to a pretrial diversion program, Section 18 tenders of guilty pleas are not convictions under Massachusetts law.

Member Regulation argues that X's plea of admission of sufficient facts should be deemed to be the equivalent of an acceptance of a plea of guilty for purposes of Section 18, and it cites the following provision of Section 18 as supportive of this position:

> If a defendant, notwithstanding the requirements set forth hereinbefore, attempts to enter a plea or statement consisting of an admission of facts sufficient for finding of guilt, or some similar statement, such admission shall be deemed a tender of a plea of guilty for purposes of the procedures set forth in this section. (Emphasis supplied).

This provision merely identifies such an attempt by a defendant to be a "tender" of a plea of guilty, however, and does not address the question of whether the court has accepted, or entered a finding on, the plea. In X's case, the record is clear that the court did not accept a plea, or enter any finding, but rather held the finding in abeyance (CWOF) pending X's successful completion of supervised release in March 2006. If X does not violate the terms of his supervised release program, then the felony charge is removed from his record. Conversely, if X violates his supervised release, then the court enters a felony conviction on his record and X becomes statutorily disqualified and subject to NASD's eligibility proceedings.

D. Conclusion

For these reasons, we conclude that X has not been convicted of a felony and therefore is not statutorily disqualified. Accordingly, he may maintain his registration with the Sponsoring Firm as an investment company/variable contracts representative.

On Behalf of the National Adjudicatory Council,

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Barbara Z. Sweeney, Senior Vice President and Corporate Secretary

3-8654 Exhibit "B"

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON D.C. 20549

DIVISION OF
MARKET REGULATION

February 21, 1992

Mr. Bruno Lederer
Associate General Counsel
New York Stock Exchange, Inc.
11 Wall Street
New York, New York 10005

Re: Definition of the term "Convicted" under Section 3(a)(39) of the Securities Exchange Act of 1934
File No. AC 92-6

Dear Mr. Lederer:

You have requested that the Division of Market Regulation ("Division") provide the New York Stock Exchange, Inc. ("NYSE" or "Exchange") with interpretive guidance concerning the meaning of the term "convicted" both generally as it is used in Section 3(a)(39) of the Securities Exchange Act of 1934 ("Exchange Act"), and specifically as it is viewed by the Division in making determinations about persons who may be subject to a statutory disqualification.[1] This letter is intended to provide you with guidance.

A. Definition of "Convicted"

As you noted in a January 7, 1992 meeting with Division staff, the term "convicted" is not defined in the Exchange Act. Nevertheless, the Investment Company Act of 1940 ("Company Act")[2] and the Investment Advisers Act of 1940 ("Advisers Act")[3] provide a definition of "convicted."[4] Therefore, in determining how convicted should be interpreted for purposes of Section 3(a)(39) of the Exchange Act, the Division has looked to the definition in the Company and Advisers Acts.

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1 See Section 3(a)(39) of the Exchange Act, 15 U.S.C. § 78c (a)(39), for the definition of "statutory disqualification."

2 15 U.S.C. § 80a et seq.

3 15 U.S.C. § 80b et seq.

4 See Section 202(a)(6) of the Advisers Act, 15 U.S.C. § 80(b)-2, and Section 2(a)(10) of the Company Act, 15 U.S.C. § 80a-2.

Under the Company and Advisers Acts, the term "convicted" is defined to include:

> a verdict, judgment or plea of guilty, or a finding of guilt on a plea of nolo contendere, if such verdict, judgment, plea or finding has not been reversed, set aside, or withdrawn, whether or not sentence has been imposed.[5]

The Division consistently has used this definition to establish whether an individual has been convicted when determining whether that person is subject to a statutory disqualification pursuant to Section 3(a)(39).

B. Need for Interpretive Guidance

Over the years, the NYSE and other self-regulatory organizations ("SROs") have informed the Division of circumstances where, because of state law provisions, there is uncertainty about whether a conviction exists.[6] These circumstances have caused SROs to question whether a conviction (i.e., the guilty verdict, plea or judgment) has been reversed, set aside or withdrawn. It is the Division's understanding that the situations causing uncertainty generally fall into three categories, each of which is addressed below.

1. Pleas of guilty or nolo contendere where no sentence has been imposed

The first situation causing uncertainty involves instances where a plea of guilty or nolo contendere has been accepted by a court but sentencing has been held in abeyance. The definition in the Company and Advisers Acts, however, makes clear that one is convicted regardless of whether a sentence has been imposed. Consequently, when a court accepts a plea of guilty, enters a judgment on a verdict of guilty, or makes a finding of guilt on a plea of nolo contendere, a conviction exists for purposes of the Company and Advisers Acts. Accordingly, the Division deems this a conviction for purposes of Section 3(a)(39). Such a conviction remains in effect until reversed, set aside or withdrawn irrespective of whether a sentence has been imposed.

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[5] Id.

[6] The term used in Section 3(a)(39) and defined in the Company and Advisers Acts is "convicted." For purposes of our discussion, "conviction" will be synonymous with "convicted."

2. Criminal cases in which a finding of guilt is held in abeyance pending the satisfactory completion of probation

The second situation that has raised questions arises when, under state law, certain criminal cases receive a disposition of a finding of guilt that is held in abeyance pending the satisfactory completion of a probationary period without incident.[7] If the probationary period passes and the convicted person does not violate the law or other specific conditions of his probation, then the conviction (i.e., the finding of guilt) is withdrawn. If, however, the person subject to this type of order violates the probationary conditions or the law during the pendency of the order, the finding of guilt is entered and the conviction remains.

Under these circumstances, the Division has determined that a person remains convicted for purposes of Section 3(a)(39) until the period of probation has been successfully completed and the court orders that the finding of guilt be withdrawn. Thus, the individual would be convicted and subject to a statutory disqualification from the time of the court's acceptance of the plea of guilty or finding of guilt until the ultimate withdrawal of the conviction upon the satisfactory completion of the probationary period. Upon the withdrawal of the conviction, the individual would no longer be subject to a statutory disqualification.[8]

3. Grants of relief from certain civil disabilities that result from a conviction

The third situation that causes uncertainty regarding the status of a conviction arises when individuals who have been convicted of crimes are granted relief from certain civil disabilities that result from that conviction by operation of state law.[9] Although these statutory provisions differ

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7 See, e.g., Md. Ann. Code art. 27, § 641 (1957) (1991 Supp.).

8 This is similar to a situation where an SRO has suspended an individual from membership in or association with a member of that SRO. During the suspension, the individual is subject to a statutory disqualification under Section 3(a)(39). Once the suspension period has expired, however, that person no longer is subject to a statutory disqualification.

9 See, e.g., Section 1203.4 of the California Penal Code.

substantially from state to state, the staff has yet to encounter a state statute granting relief from civil disabilities that completely sets aside a conviction.[10] For example, while persons who have been convicted of felonies may be permitted to obtain relief from certain disabilities that result from the felony conviction (e.g., the right to vote), those persons still may be prohibited from possessing or owning firearms or be required to disclose the existence of the conviction on licensing applications.[11]

Under these circumstances, the Division has determined that where a state's statutory provision removes some, but not all, of the disabilities or collateral consequences that result from the conviction under state law, the person remains convicted for purposes of Section 3(a)(39). Should the operation of a state law remove all consequences of the conviction and provide that, under state law, there is no conviction for any purpose, a strong presumption is created that, for purposes of the federal securities laws, the conviction has been reversed, set aside or withdrawn.

C. Conclusion

The Division believes it important to emphasize that the definition of "convicted" in the context of Section 3(a)(39) of the Exchange Act is in the first instance a question of federal law. Thus, in instances where a person has been convicted under state law, how that state treats that conviction under state law is instructive, but not controlling, on whether that conviction exists for purposes of the federal securities laws. While the

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10 Letter to Craig L. Landauer, Assistant General Counsel, National Association of Securities Dealers, Inc., from Joseph M. Furey, Assistant Director, Division of Market Regulation, dated September 9, 1991. Compare Minnesota Statute § 638.02 ("Pardons") with Minnesota Statute § 609.165 ("Restoration of Civil Rights").

11 For example, Section 1203.4 of the California Penal Code is a state statute that, although containing language indicating that relief under that provision results in a conviction being set aside, indicates that a person who had been convicted of a crime and had obtained relief under this section still could not possess a firearm and would have to disclose the existence of a conviction if applying for a state license. Reading this statutory provision in its entirety demonstrates that under California law the conviction continues to exist for certain purposes.

Division's analysis begins with the treatment of the conviction under state law, the Division will, in the final analysis, apply the definition of "convicted" provided in Company and Advisers Acts, and make its determination on a case-by-case basis.

The Division hopes that this interpretive guidance clarifies the most frequently raised questions in this area and assists the Exchange in determining whether an individual has been convicted for purposes of Section 3(a)(39) of the Exchange Act. Should you have any questions, please call me at (202) 272-7471 or Michael T. Dorsey at (202) 272-2792.

Sincerely,

Joseph M. Furey
Assistant Director

cc: Craig L. Landauer, Esq.
Assistant General Counsel
National Association of
Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

November 9, 2000

Via telefax (212-656-2576)
And first class mail

Peggy Germino
Manager
Qualifications and Registrations Department
New York Stock Exchange
20 Broad Street, 22nd floor
New York, NY 10005

Dear Ms. Germino:

On behalf of the New York Stock Exchange, Inc. ("NYSE"), you have asked the Division of Market Regulation ("Division") for interpretive guidance on the definition of "statutory disqualification" contained in Section 3(a)(39) of the Securities Exchange Act of 1934 ("Exchange Act").[1] In particular, you have asked whether certain persons would be considered "convicted," as that term is used in Section 3(a)(39), when those persons participate in a first-time drug offender rehabilitation program under a particular California Statute ("California Statute").[2] As you know, the Exchange Act does not define the term "convicted." In 1992, however, the Division provided guidance on the meaning of term as well as guidance for situations in which state law raises uncertainty as to whether a conviction exists ("1992 Letter").[3] This letter is intended to clarify our interpretation as it relates to the California Statute. For the reasons set forth below, we believe that a person for whom entry of judgment has been deferred under the California Statute would not be deemed "convicted," and thus would not be subject to a statutory disqualification.

As we explained in the 1992 Letter, in considering how to interpret "convicted" under the Exchange Act, we look to the definition of "convicted" contained in the Investment Advisers Act of 1940[4] and the Investment Company Act of 1940[5] (collectively, "the Acts"). The Acts define "convicted" to include: "a...plea of guilty...if

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1 15 U.S.C. 78c(a)(39).

2 Cal. Penal Code § 1000 et seq. (West Supp. 2000).

3 See Letter from Joseph M. Furey, Assistant Director, U.S. Securities and Exchange Commission, to Bruno Ledcrer, Associate General Counsel, NYSE (Feb. 21, 1992).

4 15 U.S.C. 80b-2(a)(6).

5 15 U.S.C. 80a-2(a)(10).

Peggy Germino
New York Stock Exchange
November 9, 2000

such...plea...has not been set aside." We used this definition to provide interpretive guidance for three situations in which state law raises uncertainty as to whether a conviction exists, including "criminal cases in which a finding of guilt is held in abeyance pending the satisfactory completion of probation." The question addressed by the staff at the time was whether a defendant is "convicted" when he or she pleads guilty or nolo contendere and a judge then defers judgment and places the defendant on probation. In considering this question, we used a Maryland Statute[6] as an example, and determined that a person is convicted for purposes of Section 3(a)(39) of the Exchange Act if a judge defers judgment and puts a defendant on probation after the judge either finds the defendant guilty or "accepts" a plea of nolo contendere.[7] The "conviction" would last until the probation is successfully completed and the charges are dismissed.

Under the California Statute, persons charged for the first time for a drug-related offense have the option of pleading guilty, and then having the judge "defer" the entry of judgment.[8] If the defendant successfully completes treatment (the "program"), the court "shall" dismiss "the criminal charge or charges" against the defendant.[9] If the defendant fails to complete the program, "the court shall render a finding of guilt to the charge or charges pled, enter judgment, and schedule a sentencing hearing...."[10]

You asked whether a person could be considered "convicted," and therefore subject to a statutory disqualification, by merely pleading guilty under the California Statute. As a preliminary matter, we note that unlike the Maryland statute, the California Statute is limited to first time drug-related offenses. Moreover, in analyzing whether a defendant has been convicted under the California Statute, we have considered two questions raised by the 1992 Letter. First, did the court accept the plea of guilty or nolo contendere, or otherwise find the defendant guilty? Second, if there is a plea of guilty (which is all that is required under the California Statute for a judge to defer entry of judgment), has it been "set aside"? The California Statute makes clear that there is no

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6 Md. Ann. Code art. 27, § 641(a) (Michie's Supp. 1999) (the judge may stay the entry of judgment " with the written consent of the person after determination of guilt or acceptance of a nolo contendere plea").

7 We are aware of statements made by Maryland courts that "a person who receives probation before judgment is not convicted of the crime for which he has been found guilty." Myers v. State, 303 Md. 639, 496 A.2d 312 (1985), and that there is a conviction only if "the person violates the probation order and a court enters a judgment on the finding of guilt." Jones v. Baltimore City Police Dept., 326 Md. 480, 606 A.2d 214 (1992). Although the staff considers these decisions an important part of our analysis, they are not dispositive with regard to whether there is a conviction under the federal securities laws.

8 Cal. Penal Code § 1000.1(a)(3).

9 Id. at § 1000.3.

10 Id.

"finding of guilt" until the court (or the probation department) makes a motion for entry of judgment, and the court renders a finding of guilt.[11] Because there has been neither a finding of guilt nor a specific acceptance of a plea of guilty, we believe that the judge has effectively "set aside" the plea pending the outcome of the probationary period. In coming to this conclusion, we have also considered language in the California Statute stating that "[a] defendant's plea of guilty...shall not constitute a conviction for any purpose unless a judgment of guilty is entered."[12]

In summary, and based on the guidance provided in the 1992 Letter, we do not believe that an individual is "convicted" under the California Statute merely by pleading guilty or nolo contendere without an adjudication, i.e., without a *finding* of guilt or an *acceptance* of the plea by a court. Should you have any questions, please call Joseph P. Corcoran at (202) 942-0756, or me at (202) 942-0061.

Sincerely,

Catherine McGuire
Chief Counsel

cc: NASDR
CBOE
AMEX

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[11] Id.

[12] Cal. Penal Code at § 1000.1(d). Although we do not consider this language dispositive in determining whether there is a conviction under the federal securities laws, it is relevant in understanding the intent behind the statute.