BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD

In the Matter of the Association of X as a Direct Participation Programs Representative with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 Decision No. SD06002 Date: 2006

I. Introduction

On May 18, 2005, the Sponsoring Firm[1] ("the Firm") completed a Membership Continuance Application ("MC-400" or "the Application") with NASD's Department of Registration and Disclosure ("Registration and Disclosure"), seeking to permit X, a person subject to a statutory disqualification, to associate with the Firm as a direct participation programs representative. In December 2005, a subcommittee ("Hearing Panel") of NASD's Statutory Disqualification Committee held a hearing on the matter. X appeared in person at the hearing, pro se, accompanied by his proposed supervisor, president of the Sponsoring Firm. LL and GW appeared on behalf of NASD's Department of Member Regulation ("Member Regulation").

For the reasons explained below, we deny the Sponsoring Firm's Application.

II. The Statutorily Disqualifying Event

In July 2004, Registration and Disclosure notified the Firm that X is statutorily disqualified because he pled guilty in a State 1 court in February 2002, to four counts of forgery

[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.

of checks, a misdemeanor in State 1.[2] The court sentenced him to 120 days in jail and three years of informal probation, and ordered him to pay $100 in restitution.

After the Firm filed its May 2005 Application[3] seeking to employ X, Member Regulation began a routine investigation of the matter that included a review of X's disciplinary, regulatory, and criminal history. Member Regulation discovered that X is subject to another statutory disqualification because in October 2003, he pled guilty in a State 1 court to the felony charge of sale and transport of marijuana.[4] For this conviction, the court sentenced X to three years of formal probation,[5] 180 days in jail, and ordered him to pay $200 in restitution. X did not disclose this felony charge (which occurred in March 2003) or the October 2003 felony conviction on any of the five Uniform Applications for Securities Industry Registration or Transfer ("Forms U4") or amendments thereto that he filed with the Sponsoring Firm.[6]

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[2] X's February 2002 misdemeanor conviction for forgery of checks meets the definition of statutory disqualification in NASD's By-Laws, Art. III, Sec. 4(g)(1)(iii) (including misdemeanor convictions involving the forgery of funds or securities within 10 years preceding the filing of an application for association with a member of NASD).

[3] At the December 2005 hearing, Member Regulation staff questioned the Proposed Supervisor about why he waited so long after Registration and Disclosure notified him in July 2004 of X's statutorily disqualified status to file the MC-400 Application. The Proposed Supervisor replied that he was not sure why, and that the dates were "curious." He maintained, however, that X has not been working for the Sponsoring Firm since January 2004. Rather, the Proposed Supervisor stated that X has been employed by an affiliate of the Sponsoring Firm, known as Firm 1, which the Proposed Supervisor identified as a consulting firm. Further details on X's alleged association with Firm 1 are discussed at greater length below.

[4] Any felony conviction within 10 years preceding the filing of an application for association with a member of NASD is a statutorily disqualifying event pursuant to NASD By-Laws, Art. III, Sec. 4(g)(1) and (2).

[5] In response to the Hearing Panel's questions at the hearing, X stated that this probation is scheduled to terminate in October 2006. X did not provide any reports from his probation officer or any other documentation regarding the status of this probation.

[6] The record shows that X filed an initial Form U4 with the Sponsoring Firm in September 2002. The Firm terminated X and filed a Uniform Termination Notice for Securities Industry Registration ("Form U5") in February 2003 (stating that the termination was "voluntary"). X filed another Form U4 with the Sponsoring Firm in May 2003. The Firm filed a Form U5 terminating X in June 2003 (stating no reason for the termination). At the hearing, the Proposed Supervisor stated that X had not been employed by the Firm during these earlier periods, but that the Proposed Supervisor was assessing X to determine if he was "ready" to be in the securities industry. X filed a third Form U4 with the Sponsoring Firm in January 2004, and filed an amended Form U4 with the Sponsoring Firm in February 2004, and again in February 2004.

III. Background Information

A. X

X first registered in the securities industry in May 2002 as a direct participation programs representative. He requalified in this same capacity in October 2005. X also passed the uniform securities agent state law examination in June 2002, and requalified in October 2005.

X was associated with Firm One from April 2002 until August 2002. When X filed a Form U4 with Firm One in April 2002,[7] he did not disclose that he pled guilty in February 2002, to four counts of forgery of checks, a misdemeanor. Firm One terminated X after four months, citing "harrassment of an employee" on the Form U5.[8]

X then associated with the Sponsoring Firm for various periods between September 2002 and June 2003. In October 2003, he submitted a Form U4 to Firm Two, on which he disclosed only the December 2001 misdemeanor charge for forgery of checks. Although he did check "yes" to the question of whether he had ever been charged with a specified misdemeanor, X provided details only of the 2001 plea to forgery of checks and not of the March 2003 felony charge and October 2003 guilty plea to sale and transport of marijuana. X stated at the hearing that Firm Two determined that it would not sponsor a statutory disqualification application on his behalf.

X again registered with the Sponsoring Firm in January 2004, which triggered Registration and Disclosure to send the July 2004 notification to the Firm regarding X's statutorily disqualified status due to the February 2002 misdemeanor conviction.

X has other criminal history. The record contains a report from the United States Department of Justice's Federal Bureau of Investigation showing that X was charged with, and convicted of, numerous criminal offenses from 1997 (when he was 15 years old) until 2003 (when he was 20 years old). These crimes include hit and run (property damage), petty theft, and possession of marijuana for sale.

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[7] In response to a letter from Member Regulation, X stated in a letter dated November 2005, that he had informed his former principals at Firm One of his "past," but that they did not complete the Form U4 on his behalf as they had promised, and they "failed to disclose properly the information I provided to them."

[8] At the hearing, X denied that he had harassed an employee at Firm One. He contended that Firm One terminated him because he had begun asking questions about its practices and because his former principals discovered that X's father was an attorney.

B. The Firm

The Sponsoring Firm became an NASD member in 1988. The Firm has one OSJ (its home office) in State 1 and no branch offices. It employs two registered principals and two registered representatives. The Firm engages in real estate syndications, private placements of securities, and sales of limited partnerships.

NASD issued two Letters of Caution ("LOC") to the Firm following its last two routine examinations in 1997 and 2001. The 1997 LOC found that the Sponsoring Firm failed to file its initial website advertisement with NASD prior to use; failed to maintain evidence of a principal's review and approval of the website information; failed to develop written supervisory procedures related to usage of electronic communications by registered persons; and failed to include information in customer account applications related to investors' investment objectives. The 2001 LOC cited the Firm for failing to file its initial website advertisement with NASD prior to use; failing to have written supervisory procedures in three specific areas; failing to provide investor education and protection information at the time of a customer purchase of direct participation programs; and failing to maintain evidence documenting the completion of the firm element requirements of the continuing education program.

In April 1990, NASD suspended the Firm for a brief period because it failed to comply with a formal written request from NASD to submit financial information. The suspension was lifted in May 1990.

NASD has commenced, but not yet completed, its 2005 routine examination of the Firm.

The record does not show any additional complaints, disciplinary proceedings, or arbitrations against the Firm.

IV. X's Proposed Business Activities and Supervision

The Firm proposes to employ X as a direct participation programs representative in its home office in State 1. The Firm states that X will be responsible for introducing products to customers.

The Sponsoring Firm also proposes that the Proposed Supervisor serve as X's responsible supervisor. The Proposed Supervisor is the president of the Sponsoring Firm, and he has been affiliated with the Firm since July 1990. He qualified as a direct participation programs representative in January 1985, a direct participation programs principal in December 1987, and a general securities principal in November 1993.

In January 1993, the State 2 Securities Commission issued an order of denial to the Firm and the Proposed Supervisor because they had not responded to the state's request to resolve deficiencies in the Firm's application for a limited offering exemption.

In August 1996, the Proposed Supervisor settled an NASD arbitration claim against him for $26,500 involving claims of breach of fiduciary duty and unsuitable recommendations.

The record does not show any other disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because: 1) X's 2002 misdemeanor conviction was serious and financial-related; 2) X failed to disclose the 2002 conviction to Firm One; 3) X committed a second statutorily disqualifying offense in 2003; 4) the 2003 felony conviction was serious and recent; 5) X did not disclose the 2003 felony charge and conviction on the Forms U4 that he filed with the Sponsoring Firm; and 6) the Firm did not propose an adequate plan of heightened supervision.

VI. Discussion

After carefully reviewing the entire record in this matter, we concur with Member Regulation's recommendation and deny the Sponsoring Firm's Application to employ X as a direct participation programs representative.

We first note that, as the applicant, the Sponsoring Firm has the burden of demonstrating to us why it is in the public interest for the Firm to employ X. *See Gershon Tannenbaum*, 50 S.E.C. 1138, 1140 (1992); *M.J. Coen*, 47 S.E.C. 558, 561 (1981) ("[A]ny member wishing to employ such a [statutorily disqualified] person . . . must 'demonstrate why the application should be granted.'"). We have examined all the evidence presented in this matter and we find that the Sponsoring Firm has fallen far short of its burden. The Firm has failed to provide any evidence to support its argument that X is able to operate responsibly in the securities industry at this time, or that the Firm and the Proposed Supervisor are capable of supervising X.

In reviewing this type of application, we consider whether the particular misconduct at issue, examined in light of the circumstances related to the misconduct and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.[9]

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[9] *See Frank Kufrovich*, Exchange Act Rel. No. 45437, 2002 SEC LEXIS 357, at *16 (Feb. 13, 2002) (upholding NASD's denial of a statutory disqualification applicant, who had committed non-securities related felonies, "based upon the totality of the circumstances" and NASD's explanation of the bases for its conclusion that the applicant would present an unreasonable risk of harm to the market or investors).

We conclude that X does present such a risk. First, the record raises serious questions as to X's integrity. X's initial statutory disqualification event – the conviction for forgery of checks in 2002 – was financially related and involved deceitful misconduct. X argues that he forged his father's name to the checks in question and that this activity represented "the tail end of a rebellious period of adolescence." The record shows, however, that X forged the checks on four separate occasions between July and September 2001, indicating a pattern of relatively recent dishonest acts. Moreover, X's ability to defraud his own father suggests to us that untrustworthy conduct toward strangers, including investors, might be possible. One of NASD's primary purposes is to promote a "high standard of business ethics" in "every facet of the securities industry." *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 315 (1985); *see also Citadel Sec. Corp.*, Exchange Act Rel. No. 49666, 2004 LEXIS 49666, at *12 (May 7, 2004) (upholding NASD's denial of a statutory disqualification application and finding that a purpose of the Securities Exchange Act of 1934 was "ensuring the integrity of the securities industry"). As the Commission has noted, the securities industry presents many opportunities for abuse and overreaching and depends heavily upon the integrity of its participants. *Halpert & Co.*, 50 S.E.C. 420, 422 (1990) (stating that the securities industry is a "field that is rife with opportunities for abuse"). X's actions lead us to seriously doubt his integrity.

Moreover, X's check forging is only one of the many criminal activities in which he has engaged. X admitted that he had a very troubled youth, and indeed, the record shows a series of criminal entries dating from 1997, when he was 15, until 2003, when he was 20. X is now 23, and he has not demonstrated to us that his past criminal misconduct is truly "in the past" and that we can have a high degree of confidence that investors will not be at risk of harm from X. X and the Proposed Supervisor made many such declarations at the hearing, but proffered no other supporting evidence. Rather, X's actions cause us to further question his judgment. In 2003, X pled guilty to the felony charge of sale and transport of marijuana. At the hearing, X testified that he became involved in this activity shortly after his brief period of employment with Firm One ended in August 2002 because he became frustrated and disenchanted with his lack of success in the securities industry. We find that such behavior tends to prove that X is not yet ready to enter the securities industry as he has not yet learned how to cope with setbacks and disappointment in a responsible manner.

Equally troubling is that X has not properly disclosed his criminal history to his employers or NASD. When he submitted his initial Form U4 to Firm One in April 2002, he failed to disclose the misdemeanor charge and conviction for check forgery. X's inaction is not excused by his written statement to Member Regulation that he had orally disclosed his "past" to the principals of Firm One who failed to disclose that information properly. X had the obligation to ensure the accuracy of the information on his Form U4 with Firm One. *See, e.g.*, *Robert E. Kauffman*, 51 S.E.C. 838, 840 (1993), *aff'd*, 40 F.3d 1240 (3d Cir. 1994) (table) ("Every person submitting registration documents [to NASD] has the obligation to ensure that the information printed therein is true and accurate.").

X continued his pattern of dishonesty when he failed to disclose the 2003 felony drug charge and conviction to the Sponsoring Firm on any of the initial Forms U4 or amendments thereto that he submitted between May 2003, and February 2004. X stated at the hearing that he

had been advised by his attorney that the felony conviction would be reduced to a misdemeanor after he had completed his three-year probation in October 2006. Yet X produced no evidence to support this assertion. Further, even if that assertion is true, during the time that X remains on probation he continues to be convicted of a felony and must therefore disclose this status. At the hearing, X also admitted that he should have checked "yes" in the box on the Form U4 to show that he had been charged with a felony. X had no explanation for this failure to disclose other than to say that he had not really read the Form U4 and had gotten into a "pattern" of checking "no" answers to all the questions. When questioned at the hearing, the Proposed Supervisor responded that he did not remember when he found out about X's 2003 drug felony charge and conviction and he did not know why it was not indicated on any of the Forms U4. In our view, X either deliberately withheld the information about the 2003 felony charge and conviction, or failed to read the Form U4 to ensure proper disclosure. In either case, his failure to disclose this critical information is inexcusable.

We also find that the Sponsoring Firm has failed to demonstrate that it and the Proposed Supervisor will be capable of providing heightened supervision to X. The Firm's proposed supervisory procedures are minimal and do not meet the standard required for firms with statutorily disqualified individuals. The Proposed Supervisor made no effort to enhance these provisions; instead, he stated at the hearing that he would comply with whatever procedures NASD wished to impose. It is the applicant's burden to show how it will effectively supervise the statutorily disqualified person; it is not the burden of NASD to describe a program of effective supervision to the applicant.

The Proposed Supervisor's inattention to details in this regard appears to be part of a pattern. For example, the MC-400 Application states that X "has been an office assistant with no customer contact." Yet at the hearing, for the first time in the application process, the Proposed Supervisor stated that X had been working for an affiliate of the Firm, Firm 1, which he described as a consulting firm. The Proposed Supervisor further asserted at the hearing that X conducted his work from a separate office, located in the Proposed Supervisor's home. The Proposed Supervisor could not explain, however, why the answers on the MC-400 appeared to indicate that X had been working at the Firm except to say that it looked like an assistant had completed the MC-400 on his behalf and he signed it without reading it. The Proposed Supervisor stated that the MC-400 answers appeared to be an "oversight," and were perhaps due to a "momentary lapse of concentration." Either the Proposed Supervisor permitted X to work for the Firm improperly as a statutorily disqualified person, or he failed to read the MC-400 and answer it completely with reference to X's association with an affiliate. In either case, the Proposed Supervisor's failure to provide accurate and complete information on the Application suggests to us that he will not be an effective supervisor for a statutorily disqualified individual such as X.

Accordingly, we find that it is not in the public interest for the Sponsoring Firm to employ X as a direct participation programs representative, and we therefore deny the Application.

On Behalf of the National Adjudicatory Council,

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary