BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X[1] as a General Securities Representative with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) Securities Exchange Act of 1934 SD08004 Date: 2008

I. Introduction

In February 2008, the Sponsoring Firm submitted a Membership Continuance Application ("MC-400" or "Application") with the Financial Industry Regulatory Authority's ("FINRA") Department of Registration and Disclosure, seeking to permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as a general securities representative. In May 2008, a subcommittee ("Hearing Panel") of FINRA's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, accompanied by his counsel, Attorney 1, the Proposed Supervisor, and the Sponsoring Firm's chief compliance officer, Employee 1. FINRA Employee 1 and FINRA Attorney 1 appeared on behalf of FINRA's Department of Member Regulation ("Member Regulation").

For the reasons explained below, we deny the Sponsoring Firm's Application.[2]

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[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] Pursuant to NASD Rule 9524(a)(10), the Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. In turn, the Statutory Disqualification Committee considered the Hearing Panel's recommendation and presented a written recommendation to the National Adjudicatory Council ("NAC"), in accordance with NASD Rule 9524(b)(1).

II. The Statutorily Disqualifying Event

X is statutorily disqualified because he consented to a January 2003 Letter of Acceptance, Waiver and Consent ("AWC"), in which FINRA imposed an unqualified bar on him. The AWC found that from March through December 2000, X violated NASD Rule 2110 by engaging in a practice known as "cherry picking"—entering certain personal and customer trades into a holding account with his then employer, Firm 1, without designating customer account numbers, and then later, at the end of the trading day, allocating the trades among these different accounts. Accordingly, X had information concerning intra-day performance of the securities underlying these trades at the time of allocation. The AWC also found that X violated NASD Rules 2110 and 2510(b) by exercising discretionary authority over the accounts of six customers by causing securities transactions to be effected in these accounts without obtaining the customers' prior written authorization and Firm 1's acceptance of the accounts as discretionary.

III. Background Information

A. X

X first registered in the securities industry as a general securities representative (Series 7) in August 1994. He requalified as a general securities representative in January 2008. He was associated with Firm 1 from July 1994 until January 2001, when Firm 1 terminated him. The Uniform Termination Notice for Securities Industry Registration ("Form U5") filed by Firm 1 in January 2001, stated that its internal review revealed that X "was involved in allocating trades both to his own account and to certain client accounts some time after those trades were executed." Firm 1 concluded that X had: "(1) executed trades for the benefit of certain client accounts without proper written documentation of discretionary trading authority; (2) executed trades without prior or simultaneous allocations of those trades to any account, instead allocating those trades to various accounts after market movements had occurred; and (3) allocated certain favorable trades to the accounts of family members or to his own account."

Since February 2001, X has been employed with Firm 2. X represents that Firm 2, a former client of his when he was employed by Firm 1, is a $400 million hedge fund that began in 1992. He states that he focuses on investor relations and marketing at Firm 2 and has "utilized [his] contact list of institutional and high net worth investors to grow the size of the fund." Currently, X is an employee of Firm 2 and markets only Firm 2's fund to potential investors. X states that he has been limited in this role, and he wants to re-enter the securities industry with the Sponsoring Firm in order to be permitted to market the securities of numerous hedge funds to institutional investors. X represents that if he is permitted to re-enter the securities industry, he will no longer be employed by Firm 2. Instead, Firm 2 will become only one of several hedge funds that he can market to potential institutional investors.

The record shows no other disciplinary or regulatory proceedings, complaints, or arbitrations against X.

B. The Sponsoring Firm

The Sponsoring Firm is based in City 1, State 1, and it has been a FINRA member since May 2005. The Sponsoring Firm has one office of supervisory jurisdiction ("OSJ"), no branch offices, and it employs two registered principals and 12 registered representatives. The Sponsoring Firm represents that it is engaged in private placements for securities and acts "as a finder for hedge funds and other alternative investments that are formed as investment partnerships and limited partnerships." Essentially, the Sponsoring Firm introduces hedge funds to institutional investors. If the investors choose to put money into the funds, the hedge fund manager pays a fee to the Sponsoring Firm.

Thus far, FINRA has conducted only one routine examination of the Sponsoring Firm—the initial examination in 2005, which resulted in a Letter of Caution ("LOC") for several violations, including: 1) failing to enforce written supervisory procedures regarding the review and subsequent approval of electronic communications; 2) failing to notify the Securities and Exchange Commission and FINRA that the Sponsoring Firm was utilizing a third party vendor to assist in retaining email communications; 3) failing to evidence supervisory review and approval by a registered principal of all incoming and outgoing electronic institutional sales material; and 4) failing to implement an adequate customer identification program.

The record shows no other disciplinary history, complaints, or arbitrations against the Sponsoring Firm.

IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes to employ X from a non-branch location in City 2. This location is the same as the one where he is currently employed by Firm 2. The Sponsoring Firm represents that X will work as a "registered sales person introducing hedge funds to sophisticated investors." The Sponsoring Firm will compensate X with a percentage of the total fees that it receives from the hedge fund managers if the investors that X introduces to the funds choose to invest in them. The Sponsoring Firm states that a "typical fee agreement is 20% of management and performance fees in arrears. Firm pays 90% of the 20% to Rep."

The Sponsoring Firm proposes that the Proposed Supervisor, the Sponsoring Firm's CEO, will be X's primary supervisor, with assistance from Employee 1, the Sponsoring Firm's chief compliance officer. The Proposed Supervisor and Employee 1 will not be located in the same office as X. Rather, they will be in the Sponsoring Firm's home office in City 1, State 1, while X remains at Firm 2's office in City 2, approximately one hour away from City 1.

The Proposed Supervisor and his wife own the Sponsoring Firm. The Proposed Supervisor first qualified as a general securities representative in March 1989, and he requalified in that capacity in April 2005. He qualified as a general securities principal (Series 24) in 2004. The Proposed Supervisor currently supervises 13 individuals at the Sponsoring Firm. The Proposed Supervisor was previously associated with six investment or investment-related firms from October 1988 until May 2003, when he formed the Sponsoring Firm.

Employee 1 qualified as a general securities representative in 1982 and as a general securities principal in 1994. He joined the Sponsoring Firm in December 2007 as the Sponsoring Firm's chief compliance officer and financial and operations principal ("FINOP") (Series 27). FINRA's Central Registration Depository ("CRD"®) shows that Employee 1 is also currently associated with six other firms in capacities ranging from general securities representative to FINOP to president.

The record shows no disciplinary history for the Proposed Supervisor or Employee 1.

The Sponsoring Firm initially proposed certain heightened supervisory procedures to govern X's activities. Member Regulation modified the Sponsoring Firm's proposal and submitted the following plan of heightened supervision that would be acceptable to the Sponsoring Firm and Member Regulation:[3]

1. *The Sponsoring Firm will amend its written supervisory procedures to state that the Proposed Supervisor is the primary supervisor responsible for X;

2. *X will not act in a supervisory capacity;

3. *X will not be permitted to engage in cold calling or cold contacts via email of potential investors. Telephone reports of X's incoming and outgoing calls will be made available to the Proposed Supervisor. The Proposed Supervisor will review and maintain copies of the phone reports. To evidence his review, the Proposed Supervisor will initial the reports and keep them segregated for review during any statutory disqualification examination;

4. *X will provide the Proposed Supervisor with a list of every proposed investor that he will contact on behalf of a hedge fund, alternative investment vehicle or private equity deal. This list will include basic suitability information and contact information. He will update the list monthly with activity information. The potential investors on the list will come from introduction agreements with the Sponsoring Firm, X's relationships with high net worth individuals and institutional investors over the past seven years, and referrals from the Sponsoring Firm, managers/sponsors and other investors. The Proposed Supervisor will keep the list of proposed investors segregated for review during any statutory disqualification examination;

5. *The Proposed Supervisor or his designee will review and pre-approve all potential investors for introduction to a manager/sponsor via an activity form that X will provide before an introduction is made. If an introduced potential investor

[3] The Sponsoring Firm placed an asterisk next to all of the supervisory conditions as they are all special for X and not required of the Sponsoring Firm's other registered representatives.

makes an investment with a manager/sponsor before the pre-approval has been obtained via an activity form, X will forfeit his compensation for the introduction and an internal review will be commenced and documented by the chief compliance officer. The outcome of that review will be placed in the special supervision folder. One possible outcome is termination. If X is terminated, the Sponsoring Firm will list the cause of termination on his Form U5 as his having violated heightened supervisory procedures. The Proposed Supervisor will copy and initial the activity form to evidence his review and will keep it segregated for review during any statutory disqualification examination;

6. *For the purposes of client communication, X will only be allowed to maintain an email account that is held at the Sponsoring Firm, with all emails being filtered through the Sponsoring Firm's email system. If X receives a work-related email in his personal email account, he will immediately forward it to Employee 1. Employee 1 or his designee will conduct a weekly review of all email communications that are either sent or received by the Sponsoring Firm. Employee 1 will print the documentation of this email review and maintain it in a heightened supervision file that he will keep segregated for review during any statutory disqualification examination;

7. *Employee 1 will approve all of X's outgoing correspondence (other than email) prior to mailing, and all incoming mail addressed to X will first be sent to the home office of the Sponsoring Firm, to be reviewed by Employee 1, and then forwarded to X;

8. *The Proposed Supervisor will visit X every three weeks in X's City 2 office to review the activity forms and any files regarding introduced investors. The Proposed Supervisor will document the results of those visits and keep the documentation segregated for review during any statutory disqualification examination;

9. *All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review and then to the Sponsoring Firm's compliance department. The Proposed Supervisor will prepare a memorandum to the file as to the measures he took to investigate the merits of the complaint (e.g., contact with the customer) and the resolution of the matter. The Proposed Supervisor will keep documents pertaining to these complaints segregated for review during any statutory disqualification examination;

10. *If the Proposed Supervisor is to be on vacation or out of the office, Employee 1 will act as X's interim supervisor;

11. *The Proposed Supervisor must certify quarterly (March 31, June 30, September 30, and December 31) to the Sponsoring Firm's compliance department that he

and X are in compliance with all of the above conditions of heightened supervision to be accorded X; and

12. *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 responsible supervisor from the Proposed Supervisor to another person.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be approved because: 1) X's disqualifying event, though serious, was his only infraction while employed in the securities industry; 2) X has not engaged in any intervening misconduct since his disqualifying event; 3) X's proposed activities are unrelated to his disqualifying event; 4) a sufficient period of time has passed since X's disqualifying event; 5) the Sponsoring Firm and the Proposed Supervisor are suitable to supervise X; and 6) the Sponsoring Firm has submitted a solid plan of heightened supervision.

VI. Discussion

After carefully considering the entire record in this matter, including the testimony and other evidence submitted at the hearing, we reject Member Regulation's recommendation and find that X's re-entry into the securities industry would pose a serious risk to the investing public. We therefore deny the Sponsoring Firm's Application to employ X as a general securities representative.

A. The Sponsoring Firm Has Not Made the Strong Showing Necessary for the NAC to Approve X's Re-Entry into the Securities Industry Despite FINRA's Recent Imposition of an Unqualified Bar on X

1. The Standard

X is statutorily disqualified due to FINRA's imposition on him of an unqualified bar—FINRA's most serious sanction—in January 2003. We have previously noted, in several earlier statutory disqualification cases involving unqualified FINRA imposed bars, that "[b]ars are intended to prohibit completely a person's ability to engage in any future securities business with any member firm, thus precluding re-entry into the securities industry absent extremely unusual circumstances." *See The Ass'n of X as a Gen. Secs. Representative*, Redacted Decision No. SD01016, at 4 (2001), *available at http://www.finra.org/web/groups/enforcement/documents/nac_stat_dq_decisions/p011593.pdf*; *The Ass'n of X as an Inv. Co. & Variable Contracts Products Representative*, Redacted Decision No. SD99023, at 3 (1999), *available at* http://www.finra.org/web/groups/enforcement/documents/nac_stat_dq_decisions/p012616.pdf. Thus, a FINRA-barred applicant is required to make an extremely strong showing for us to find that approval of an application for re-entry would serve the public interest. *The Ass'n of X as an Inv. Co. &.Variable Contracts Products Representative*, Redacted Decision No. SD99023 at 3. Particularly given the circumstances under which FINRA imposed the unqualified bar on X, we

find that the Sponsoring Firm has not made the strong showing necessary for our approval of its Application for X to re-enter the securities industry. *See Gershon Tannenbaum*, 50 S.E.C. 1138, 1140 (1992) ("In NASD proceedings . . ., the burden rests on the applicant to show that, despite the disqualification, it is in the public interest to permit the requested employment."); *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.'").

2. X Consented to an AWC that Imposed an Unqualified Bar on Him for Serious Securities-Related Misconduct

X was represented by counsel when he consented to the AWC with FINRA that imposed an unqualified bar on him. FINRA imposed the bar because X admitted that, while employed by Firm 1, he engaged in several questionable practices during a 10-month period from March through December 2000. First, X engaged in a practice known as "cherry picking"—he purchased securities in an omnibus account and delayed allocation of the purchases until later in the day, after he had had an opportunity to see whether the securities appreciated in value. Firm 1 terminated X for this misconduct in January 2001, stating in X's Form U5 that its internal review showed that he had "allocated certain favorable trades to the accounts of family members or to his own account." Second, X exercised discretionary authority over the accounts of six customers by causing securities transactions to be effected in these accounts without obtaining the customers' prior written authorization and Firm 1's written acceptance of the accounts as discretionary.

At the hearing, and in documents submitted for the record, X attempts to explain the "cherry picking" violation by claiming that he did not know that the practice violated FINRA rules. At the hearing, his counsel also asserted that the unqualified bar imposed on X may have been an excessive sanction. We reject X's attempt to introduce evidence and arguments to excuse the misconduct for which FINRA barred him in 2003, as such would constitute an impermissible collateral attack on the underlying previously litigated statutorily disqualifying event that brings X before us now. *See Joseph Frymer*, 49 S.E.C. 1181, 1182 (1989).

X engaged in serious securities-related misconduct and FINRA imposed an unqualified bar on him. X's conduct was deceitful, as he exercised discretion in customers' accounts without written permission and provided himself with repeated opportunities throughout a 10-month period to improperly allocate favorable securities trades to his personal and family accounts at the expense of his clients' accounts. X argues that he was not deceitful with Firm 1 because he made no attempt to conceal his practices and because he entered and allocated the trades at issue on an order entry screen that was seen by his supervisor at Firm 1. This argument, however, does not address the deceit that X exercised upon his customers, who were not aware that X was exercising discretion in their accounts without their written permission, and that he was holding trades, exercising post-transaction judgment, and allocating trades into accounts at the end of the trading day. Such conduct violates the fundamental relationship of trust that must exist between a representative and his customer in the securities industry. *See Gerson Asset Mgmt., Inc., et al.*, Exchange Act Rel. No. 52880, 2005 SEC LEXIS 3120, at *2-3 & 11 (Dec. 2, 2005) (imposing bar on registered representative who purchased securities in an omnibus account and unfairly

allocated the trades to his own and customer accounts later in the trading day); c*f. Paul Joseph Sheehan*, Inv. Advisors Act Rel. No. 2211, 2004 SEC LEXIS 214, at *1 (Feb. 3, 2004) (imposing bar on investment advisor for engaging in "a fraudulent, cherry-picking scheme whereby he improperly allocated profitable securities trades to his personal accounts at the expense of his clients' accounts"); *see also Andrew J. Hardin*, 2007 NASD Discip. LEXIS 24, at *1 (NASD NAC July 27, 2007) (imposing sanctions on representative for exercising discretionary authority in a customer's account without prior written authorization from the customer and written approval from the firm). We will not grant this Application's request for relief from such a bar in the absence of the requisite strong showing of exceptional circumstances, which we do not find in the Sponsoring Firm's Application.

3. FINRA Very Recently Imposed an Unqualified Bar on X

FINRA imposed its most serious sanction on X in January 2003. Thus, X has served his bar for less than five years before the Sponsoring Firm filed its MC-400 in this matter.[4] Given the reasons for FINRA's imposition of the bar on X, and the fact that he has previously exhibited an inability to follow securities rules and regulations, we conclude that insufficient time has elapsed for X to demonstrate his willingness or ability to operate responsibly in the securities industry.

B. The Sponsoring Firm's Proposed Supervisory Structure for X Is Inadequate

Next, we consider the nature and disciplinary history of the Sponsoring Firm and the proposed supervisory structure for X. We note that the Sponsoring Firm has no formal disciplinary history, and that the proposed primary supervisor, the Proposed Supervisor, is well qualified and has no disciplinary history. This lack of disciplinary history, however, does not outweigh our very serious concerns, as stated above, about returning X to the securities industry even if he is subject to intensive supervision.

Additionally, we have some major concerns with the Sponsoring Firm's proposed supervisory procedures. *See Citadel Sec. Corp*., Exchange Act Rel. No. 49666, 2004 SEC LEXIS 949, at *13 (May 7, 2004) ("[I]n determining whether to permit the employment of a statutorily disqualified person, the quality of the supervision to be accorded that person is of utmost importance. We have made it clear that such persons must be subject to stringent oversight by supervisors who are fully qualified to implement the necessary controls.") (citations omitted). Most importantly, the Sponsoring Firm proposes that the Proposed Supervisor and the back-up supervisor, Employee 1, will be located in the Sponsoring Firm's home office in City 1, State 1, while X works from a non-branch location in City 2. The two offices are separated by a

[4] We reject X's argument that more time has elapsed because the misconduct occurred in 2000, and Firm 1 terminated him in 2001. Our calculation of time begins with the statutorily disqualifying event before us, which is the unqualified bar that FINRA imposed on X in the January 2003 AWC.

distance of 35 miles. Further, during the hearing, the Proposed Supervisor stated that X's location may change in the future, if X needs to work from the offices of other hedge fund managers as his business expands. Therefore, X could be located even further from his supervisors in the near future. The Sponsoring Firm proposes that the Proposed Supervisor will visit X in City 2 "every three weeks . . . to review the activity forms and any files regarding introduced investors."[5] We find that this proposal does not meet the "stringent oversight" standard required for supervision of a statutorily disqualified individual. Even given the Sponsoring Firm's limited business model and low volume business, we find it unacceptable for a person who has been unqualifiedly barred by FINRA for a securities-related violation to re-enter the securities business with such minimal face-to-face supervision.

We are also not persuaded by the Sponsoring Firm's assertions that it is capable of adequately monitoring X from a distance, given that we find certain of its proposed heightened supervisory procedures to be similarly unacceptable. For example, the Sponsoring Firm proposes that Employee 1 will conduct only a "weekly review of all of X's email communications" while providing immediate review of other incoming and outgoing correspondence. On its face, this proposal is inadequate, and it becomes even more so because X testified at the hearing that virtually all of his client communications are via email. Thus, the Sponsoring Firm is actually proposing only a weekly review of all of X's written communications with his clients in addition to the absence of a daily on-site supervisor. At the hearing, the Sponsoring Firm indicated a willingness to increase its review of X's written client communications, although Employee 1 stated that he hoped the review would not have to be conducted daily. Since X testified that he writes only 10-15 emails per day, we find it surprising that the Sponsoring Firm apparently considers it too burdensome to conduct a daily review of his emails. We also note that the Sponsoring Firm's 2005 LOC found deficiencies in the Sponsoring Firm's review and approval of electronic communications. We find the Sponsoring Firm's reluctance to assume a more stringent review of X's activities to be indicative of its failure to understand the serious responsibilities that arise with the sponsorship of a statutorily disqualified individual.

Moreover, we are concerned that the Proposed Supervisor and back-up supervisor are not capable of assuming the serious duties of supervising a statutorily disqualified individual such as X. Although the Proposed Supervisor has no disciplinary history, he is the CEO of the Sponsoring Firm, and he is a producing principal. The Proposed Supervisor also currently directly supervises 13 other individuals. As for Employee 1, CRD shows that he is simultaneously associated with six other firms in different locations and in varying capacities. The Sponsoring Firm's proposed supervisory structure therefore does not place the primary daily responsibility for X squarely in the hands of a single capable and available supervisor.

Accordingly, we find that the proposed procedures do not demonstrate that the Sponsoring Firm will be able to exercise the necessary control over X's activities.

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[5] The Proposed Supervisor testified at the hearing that he hoped he could reduce the visits to once a month sometime in the future.

VII. Conclusion

In conclusion, we find that it is not in the public interest, and would create an unreasonable risk of harm to the market or investors, for X to become associated with the Sponsoring Firm as a general securities representative. We therefore deny the Application.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith, Senior Vice President
and Corporate Secretary