BEFORE THE NATIONAL ADJUDICATORY COUNCIL

FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X[1] as a Financial and Operations Principal with The Sponsoring Firm	Redacted Decision Notice Pursuant to Section 19(d) of the Securities Exchange Act of 1934 SD09002 Date: 2009

I. Introduction

On March 19, 2008, the Sponsoring Firm filed a Membership Continuance Application ("MC-400" or "the Application") with the Department of Registration and Disclosure at the Financial Industry Regulatory Authority ("FINRA"), seeking to permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm as a financial and operations principal ("FINOP"). In 2008, a subcommittee ("Hearing Panel") of FINRA's Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, accompanied by the Proposed Supervisor, the Sponsoring Firm's president and chief compliance officer. FINRA Employee 1, FINRA Attorney 1, and FINRA Attorney 2 appeared on behalf of the Department of 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.

II. The Statutorily Disqualifying Event

From March 2003 until September 2006, X was a partner, the chief financial officer, and the FINOP of Former Firm 1. Former Firm 1 was a member organization of the Philadelphia Stock Exchange ("PHLX"). X is statutorily disqualified because in September 2006, PHLX issued a Decision and Order of Offer of Settlement, which found, in pertinent part, that X caused Former Firm 1 to maintain inaccurate books and records with respect to its net capital, and to file 21 inaccurate Financial and Operational Combined Uniform Single ("FOCUS") reports between June 2003 and February 2005.[3] Without admitting or denying the charges, X consented to: (1) a 10-year suspension from membership in PHLX and from employment or association in any capacity with any PHLX member or member organization;[4] (2) a censure; and (3) a $70,000 fine, for which X was held jointly and severally liable with Former Firm 1 and its president, President 1.

III. Background Information

A. X

X first registered in the securities industry as a general securities representative in 1992. As mentioned above, from March 2003 until September 2006, X was associated with Former Firm 1. From April 1996 to May 2006, X was associated with Former Firm 2, a FINRA member firm and an affiliate of Former Firm 1. He was registered as a general securities representative, a general securities principal, an options principal, a FINOP, and an equity trader limited representative. Since June 2006, X has served as the chief executive officer of Company 1, a business development and accounting consulting company. He testified that he has been providing part time accounting consulting services, as well as "compliance" consulting services "for a couple of hedge funds in [State 1]."

X has one disciplinary event in addition to the statutorily disqualifying event. In 2006—less than six months before the PHLX settlement—FINRA accepted a Letter of Acceptance,

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[3] The PHLX settlement contains findings that X engaged in numerous other violations in addition to the recordkeeping violations. We focus in the text on X's recordkeeping violations primarily because Member Regulation's recommendation letter characterized them as the only "relevant" findings. Although we disagree with Member Regulation's assessment, we are concerned that X, who appeared pro se, may have been left with inadequate notice that his other violations could be relevant in this proceeding. Moreover, because of the seriousness of X's recordkeeping violations, we are able to decide this Application without specifically considering the import of X's other violations.

[4] *See* Section 3(a)(39) of the Securities Exchange Act of 1934 ("Exchange Act") (providing that a person who "has been and is . . . suspended from membership or participation in, or . . . suspended from being associated with a member of, any self-regulatory organization" is subject to a statutory disqualification); FINRA By-Laws Art. III, Sec. 4.

Waiver, and Consent ("AWC") from X, which found that he: (1) during the period from November 2004 to February 2005, inaccurately calculated Former Firm 2's net capital, causing it to maintain inaccurate books, records, and FOCUS reports, and to fail to maintain required minimum net capital; (2) during 2004, failed to establish supervisory procedures to monitor the positions of Former Firm 2's trading desk and to ensure that minimum net capital requirements were maintained; and (3) failed to review the correspondence, or conduct an annual review, of Former Firm 2's Office of Supervisory Jurisdiction ("OSJ"). Without admitting or denying the findings, X consented to a $35,000 fine (joint and several with Former Firm 2), a censure, and a 30-day suspension from associating with any member firm as a FINOP.

B. The Sponsoring Firm

The Sponsoring Firm, which is based in City 1, State 1, became a FINRA member in 1998. It has one OSJ and one branch office. The Sponsoring Firm employs seven persons, including five representatives and two principals. The Sponsoring Firm is authorized to engage in numerous types of business, including retail sales of equities. It acts as an introducing broker-dealer and clears through Clearing Firm 1. The record shows no complaints, disciplinary proceedings, or arbitrations against the Sponsoring Firm.

The Sponsoring Firm has had three cycle examinations since 2002. In 2008, a cycle examination concerning the Sponsoring Firm commenced, but it is not yet complete.

The Sponsoring Firm had a cycle examination in 2006 that resulted in a compliance conference. Among the items for discussion were that the Sponsoring Firm: (1) accepted investor funds for units of an offering purchased after the expiration of the offering, in violation of NASD Rule 2110; (2) failed to develop specific heightened supervisory procedures for a registered representative who was under heightened supervision, in violation of NASD Rule 3010; (3) failed to accrue properly on its books and records commissions receivable and commissions payable, and failed to compute properly undue concentration charges, in violation of Exchange Act Rule 17a-3; (4) failed to maintain order tickets and confirmations in certain agency transactions, as required by Exchange Act Rule 17a-4; (5) failed to complete timely the Firm Element of Continuing Education, as required by NASD Rule 1120(b)(2); and (6) failed to establish adequate written supervisory procedures related to the sale of Over the Counter Bulletin Board and penny stock securities, as required by NASD Rule 3010(b)(1).

The Sponsoring Firm had a cycle examination in 2002 that resulted in a Letter of Caution. That letter stated that the Sponsoring Firm: (1) failed to establish, maintain, and enforce certain written supervisory procedures, in violation of NASD Rule 3010(b)(1); (2) failed to reflect in the Sponsoring Firm's general ledger all assets, liabilities, income, and expenses of the Sponsoring Firm, in violation of Exchange Act Rule 17a-3; and (3) failed to prepare accurate FOCUS reports, on three occasions, as required by Exchange Act Rule 17a-5.

IV. X's Proposed Business Activities and Supervision

A. Proposed Business Activities

The Sponsoring Firm proposes to employ X as a FINOP in its main office in City 1, State 1. X represents that he has "experience maintaining the books and records of a broker-dealer as well as calculating net capital requirements, firm positions, haircuts, liabilities, allowable assets, and . . . all facets necessary to complete and file a FOCUS Report on a monthly basis." The Sponsoring Firm would compensate X on a salary basis, and he would have no equity stake in the Sponsoring Firm. X would have no supervisory duties.

B. Supervision

The Sponsoring Firm proposes that the Proposed Supervisor would be X's primary supervisor. The Proposed Supervisor has been employed in the securities industry since 1978. The Proposed Supervisor has been associated with the Sponsoring Firm since July 2007 and serves as the Sponsoring Firm's president and chief compliance officer. The Proposed Supervisor is registered as a general securities principal, a general securities representative, and an equity trader. Prior to associating with the Sponsoring Firm, the Proposed Supervisor was registered with Former Firm 2 from April 2005 to June 2007, a period when X was also at that firm.

The Sponsoring Firm represents that the Proposed Supervisor "has been a registered principal . . . since 1996 and has extensive experience as a branch manager." The Proposed Supervisor currently supervises three registered representatives who "act[ ] as customer service [representatives] and order taker[s] for agency trades." The Proposed Supervisor testified that he has supervised traders, but never any FINOPs, who were subject to heightened supervision.

In its recommendation letter, Member Regulation referenced numerous criminal, regulatory and termination events on the Proposed Supervisor's Central Registration Depository ("CRD"®) record, most of which were immaterial, dated, or not relevant to our analysis. Only two such events warrant brief mention, and only one of those is securities related.

In April 1976, the Proposed Supervisor pled nolo contendre to charges of involuntary sexual battery, a felony. The Proposed Supervisor was sentenced to three years' probation. The Proposed Supervisor's CRD record indicates that the "charges were dropped" after he served his probation.

In July 2006, a customer filed an arbitration complaint alleging that the Proposed Supervisor mismanaged the customer's assets when filling an order. The customer requested at least $295,000 in compensatory damages. The Proposed Supervisor testified that the customer named "everybody" at Former Firm 2 in the complaint, except the registered representative who handled the account. The Proposed Supervisor further testified that he settled the allegations against him for "$3,000 nuisance money," without admitting or denying the allegations.

In addition to proposing that the Proposed Supervisor supervise X, the Sponsoring Firm has proposed a plan of heightened supervision. That plan generally would involve the Proposed Supervisor reviewing X's work, and an outside compliance firm reviewing the Sponsoring Firm's FOCUS reports.

V. Member Regulation's Recommendation

Member Regulation recommends that the Application be denied because: (1) X's disqualifying event is of a serious nature and concerns a failure to comply with industry practices; (2) an insufficient period of time has elapsed since the PHLX settlement to prove that X is able to conduct himself in an ethical manner; and (3) X has another regulatory matter in his disciplinary history that is serious and warrants concern.[5]

VI. Discussion

For the reasons explained below, we deny the Sponsoring Firm's Application to employ X as a FINOP.

In evaluating an application like this, we assess whether the sponsoring firm has demonstrated that the proposed association of the statutorily disqualified individual is in the public interest and does not create an unreasonable risk of harm to the market or investors. *See* Redacted Decision No. SD06003, slip op. at 5 (NASD NAC 2006), *available at* www.finra.org; *see also Frank Kufrovich*, 55 S.E.C. 616, 624 (2002) (holding that FINRA "may deny an application by a firm for association with a statutorily disqualified individual if it determines that employment under the proposed plan would not be consistent with the public interest and the protection of investors"); FINRA By-Laws, Art. III, Sec. (3)(d). Factors that bear on our assessment include the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, the totality of the regulatory and criminal history, and the potential for future regulatory problems. We also consider whether the sponsoring firm has demonstrated that it understands the need for, and has the capability to provide, adequate supervision over the statutorily disqualified person.

X's disqualifying event is highly serious, and weighs heavily against the Application. X caused Former Firm 1 to maintain inaccurate books and records with respect to its net capital, and caused the filing of 21 inaccurate FOCUS reports between June 2003 and February 2005. X's net capital calculations were substantially inaccurate, with errors ranging from $90,833 to $4,760,558, and usually involved overstatements of net capital. He violated financial responsibility regulations that are intended to provide fundamental protections for investors. *See, e.g.*, *Blaise D'Antonai & Assoc. v. SEC*, 289 F.2d 276, 277 (5th Cir. 1961) ("The net capital rule is one of the most important weapons in the Commission's arsenal to protect investors. . . . [T]he

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[5] Initially, Member Regulation also argued that the Proposed Supervisor, based on his "criminal past" and his "regulatory history," is unsuitable to supervise X. As explained below, Member Regulation abandoned this line of argument at the hearing.

rule operates to assure confidence and safety to the investing public."). The egregious nature of X's violations of industry regulations is reflected in the substantial 10-year suspension that PHLX imposed on him. *Cf. William J. Haberman*, 53 S.E.C. 1024, 1028 (1998) (finding that the sentence imposed on a statutorily disqualified person "may properly indicate the seriousness of [the] offense"), *aff'd*, 205 F.3d 1345 (8th Cir. 2000) (Table).

The nature of X's disqualifying event also creates the strong potential for future regulatory problems, considering that X seeks to associate with the Sponsoring Firm as a FINOP. A FINOP "is charged with the member firm's compliance with applicable financial reporting and net capital requirements." *Luther E. Oliver*, 51 S.E.C. 914, 917 (1993). He "prepares and is responsible for the accuracy of financial reports as well as any other matter involving the financial and operational management of the member firm." *Id*. We are concerned that X's statutorily disqualifying event involved failures to comply with the very kinds of financial responsibility regulations with which he would have to comply were we to approve this Application. *Cf. id.* (denying application by statutorily disqualified person to remain associated with his firm as a FINOP, finding that his "duties . . . will involve similar recordkeeping responsibilities" to those that caused his felony conviction for misapplying funds).

Moreover, X's disqualifying event is recent. The underlying misconduct occurred between June 2003 and February 2005, and PHLX issued the settlement order in September 2006. X has served only two years of his 10-year suspension. *Cf. Haberman*, 53 S.E.C. at 1030 & n.21 (finding that applicant's six-year old statutorily disqualifying event, a felony conviction for money laundering, was "recent" and supported denying application). And X has not pointed to any activities since he became statutorily disqualified that convince us he is currently capable of complying with applicable industry regulations.[6] Considering these facts, we find that an insufficient period of time has elapsed since the PHLX settlement to prove that X is able to conduct himself in an ethical manner.

X's primary arguments in support of the Application are essentially a litany of collateral attacks on the PHLX settlement. While X does not deny the underlying findings of violations, he does not admit them either. He claims that he was never presented with any "backup documents" demonstrating the violations and that he signed the PHLX settlement only because his attorney "urged" him to do so. In addition, X generally assigns blame for any alleged underlying violations to President 1, the president of Former Firms 1 and 2, asserting that President 1 "hid[ ] . . . improprieties" and withheld information from X. X claims he was

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[6] X testified that, since becoming statutorily disqualified, he has "taken some efforts . . . to further [his] education, including applying to be a . . . Certified Fraud Examiner," which he claimed "does independent testing[,] . . . investigations and forensic-type work with regard to fraud and [anti-money laundering] testing." X did not testify, however, that he has been *certified* as a fraud examiner. *See Association of Certified Fraud Examiners, Certification Process*, http://www.acfe.com/Membership/certification-process.asp (last visited Oct. 28, 2008) (explaining that certification as a Certified Fraud Examiner requires passing a qualification examination and obtaining approval of the certification committee).

"powerless to effect change" at the Former Firms 1 and 2 or "control President 1." X also asserts inadequacies in the representation he received from the attorney who represented him before PHLX, Attorney 1. X asserts that Attorney 1 had "inherent conflict[s]" of interest, because he simultaneously represented X, Former Firm 1, and President 1, and allegedly had a personal financial interest in Former Firm 1. X further alleges that Attorney 1 misrepresented to X that the PHLX settlement would not affect his ability to work for FINRA member firms.

Collateral attacks like these, however, are not properly considered in eligibility proceedings. *See Jan Biesiadecki*, 53 S.E.C. 182, 185 (1997) (finding that the doctrine of collateral estoppel and the NASD's By-Laws limited the statutorily-disqualified individual's right to present evidence that attempted to dispute or undermine aspects of the disqualification); *see also Michael B. Scheft*, 48 S.E.C. 710, 712 (1987).[7] Instead of collaterally attacking the PHLX order, what X needed to demonstrate was that, despite his statutory disqualification, he understands how to ensure compliance with the industry rules and regulations for which he would be responsible and is now capable of doing so. He has made no such showing.

In this regard, X not only purports to lack knowledge of many of the facts underlying the violations in the PHLX settlement, he does not acknowledge the breadth of the findings contained therein. As a result, X has given us the impression that he lacks a general awareness of the findings in the PHLX settlement and has not even begun to grapple with how he would prevent similar violations in the future. *Cf. American Inv. Serv., Inc.*, 54 S.E.C. 1265, 1273 (2001) (denying a firm's application to associate with statutorily disqualified persons who "demonstrate[d] a troubling lack of understanding . . . of their own role in the events that were at issue in the [statutorily disqualifying event]").

Even as to what X does admit knowledge of, he has not provided the necessary reassurances of measures that he would employ to ensure compliance with industry rules and regulations. X blames his underlying violations on President 1, but he has provided little explanation about how he would prevent a similarly uncooperative supervisor from causing similar violations in the future. Registered FINOPs have independent compliance responsibilities. *Cf. George Lockwood Freeland*, 51 S.E.C. 389, 392-93 (1993) (holding that a FINOP cannot shift responsibility for compliance with net capital and financial reporting requirements to the owner of the firm who withheld information); *Gilad J. Gevaryahu*, 51 S.E.C. 710, 712-13 (1993) (holding that FINOP's contention that president lied and withheld information did not relieve FINOP of responsibility for net capital violations because "[o]nce [he] agreed to serve as the firm's FINOP, and for as long as he retained that position, he was responsible for carrying out its attendant duties and obligations"). Should a FINOP encounter uncooperative superiors, he has a number of tools to force compliance. Among other tools, he can inform firm's board of directors or, where that would not be a meaningful step, blow the whistle to regulators or resign. That X still believes he was "powerless to effect change" at

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[7] Likewise, in signing the PHLX offer of settlement, X expressly waived any right to a review of that settlement "in any . . . forum or by any . . . means."

Former Firms 1 and 2 reflects that he does not yet appreciate those independent compliance responsibilities.

In an effort to show us otherwise, X emphasizes that he "promptly" and "voluntarily" resigned from Former Firm 2 in 2006, "upon the belief that . . . President 1 . . . was not following NASD regulations." We are not persuaded, however, that X acted with appropriate haste or resigned as a result of his failure to ensure compliance. X's violations occurred during the 18-month period ending in 2005, and it was not until at least *another* 18 months passed that he resigned.[8] In addition, X was aware of numerous red flags months before he terminated his employment. X, who had worked with President 1 for nearly four years, testified that "I had concerns over President 1's character in the final year." X also admitted that he was aware, approximately six months prior to his resignation from Former Firm 2, of possible improprieties "[w]ith regards to the treatment of the books of Former Firm 1." In addition, more than two months before his resignation from Former Firm 2, X signed an AWC finding that, among other things, President 1 and Former Firm 2: (1) permitted a statutorily disqualified person to associate with Former Firm 2, in violation of an SEC bar order; (2) permitted President 1 to engage as an unregistered principal of Former Firm 2 from 2003 to 2005; (3) engaged in violations of anti-money laundering procedures; and (4) paid commissions to a non-registered entity of the Sponsoring Firm.[9] Given these warning signs, X's resignation was too little, and too late, to demonstrate a readiness to act in an ethical manner.

We are equally unmoved by X's representation that he provided information to FINRA about Former Firm 2 and President 1 at an investigative interview in 2008 "although [he was] not registered with any member firm." When he appeared, X remained within FINRA's jurisdiction and was only doing what he was *required* to do. FINRA By-Laws, Art. V, Sec. 4 (describing FINRA's two-year retained jurisdiction over former registered persons). X's apparent belief that he was performing an act above and beyond that which he was required to do displays a lack of understanding of his professional obligations.

Based on this record, we find that the Sponsoring Firm has failed to demonstrate that X is currently capable of complying with industry regulations were he to act as the Sponsoring Firm's FINOP.[10]

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[8] We question X's claim that he terminated his association with Former Firms 1 and 2 early in 2006. Certain statements in X's CRD record indicate that he was associated with Former Firm 1 until late 2006.

[9] X testified that, upon receiving a request from a customer to withdraw funds from an account that did not hold any funds, he finally felt he had "enough evidence" about the suspicious business practices at Former Firm 2 to warrant his resignation.

[10] We do not reach the issue of whether the Sponsoring Firm's proposed plan of heightened supervision was sufficient, except to note that our rejection of the Application is not based on concerns about the Proposed Supervisor. Member Regulation initially argued that the Proposed Supervisor would be "unsuitable to supervise X," based on the Proposed Supervisor's criminal

[Footnote continued on next page]

VII. Conclusion

Accordingly, we conclude that it is not in the public interest, and would create an unreasonable risk of harm to the market or investors, to permit X to associate with the Sponsoring Firm as a FINOP. We deny the Sponsoring Firm's Application.

On Behalf of the National Adjudicatory Council,

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Marcia E. Asquith
Senior Vice President and Corporate Secretary

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history and its assertion that the Proposed Supervisor "has not always complied with industry rules." But when pressed by the Hearing Panel—who pointed out that the Proposed Supervisor's criminal events occurred "anywhere from 19 to 36 years ago," that several such events were misdemeanors that the Uniform Application for Securities Industry Registration or Transfer does not require be disclosed, and that Member Regulation had based its recommendation in part on mere *allegations* against the Proposed Supervisor in a *pending* customer complaint—Member Regulation backpedaled, even conceding that the criminal matters were not relevant. Indeed, we see no evidence that the Proposed Supervisor would have been unsuitable to supervise X. Considering the Proposed Supervisor's long and relatively unblemished career in the securities industry, we find that his old criminal events and the customer complaint against him—which the Proposed Supervisor ultimately settled for a *de minimis* amount without admitting or denying any allegations—have limited bearing on the Proposed Supervisor's current ability to supervise.