

NASD OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,

Complainant,

v.

DAY INTERNATIONAL SECURITIES
(CRD No. 23405),
San Jose, CA.

and

DOUGLAS CONANT DAY
(CRD No. 1131612),
San Jose, CA,

and

RONALD WINSTON WOOD
(CRD No. 1446452),
Lincoln, CA,

Respondents.

Disciplinary Proceeding
No. C01020023

Hearing Officer—Andrew H. Perkins

HEARING PANEL DECISION

December 30, 2003

Member firm (1) violated its membership agreement, in violation of NASD Conduct Rule 2110; (2) conducted a securities business while failing to maintain its minimum net capital, in violation of Exchange Act Rule 15c3-1 and NASD Rule 2110; and (3) held customer funds and securities and failed to establish a Special Reserve Bank Account for the Exclusive Benefit of Customers, in violation of Exchange Act Rule 15c3-3 and NASD Rule 2110. The firm and Wood were jointly and severally fined a total of \$50,000, and suspended in all capacities for 30 business days for each violation. Day was fined a total of \$30,000 and suspended for 30 business days for violating the

membership agreement and 30 business days for failing to establish and maintain a Special Reserve Bank Account for the Exclusive Benefit of Customers. The foregoing suspensions run consecutively.

In addition, member firm and Respondent Day permitted Respondent Wood to function in a registered capacity while his registration was inactive for failing to comply with the Regulatory Element of the continuing education rule, in violation of NASD Membership and Registration Rule 1120(a) and NASD Conduct Rule 2110. The Respondents were fined \$3,000 each for this violation.

Appearances

David A. Watson, Regional Counsel, San Francisco, CA (Rory C. Flynn, Chief Litigation Counsel, Washington, DC, Of Counsel) appeared on behalf of the Department of Enforcement.

Douglas Conant Day appeared on behalf of Day International Securities and himself.

Ronald Winston Wood appeared on his own behalf.

DECISION

I. INTRODUCTION

The Department of Enforcement (the “Department”) brought this disciplinary proceeding against Day International Securities (“Day International” or the “Firm”), Douglas Conant Day (“Day”), and Ronald Winston Wood (“Wood”) charging various violations of NASD’s conduct rules. Three causes of the Complaint center on the Firm’s violation of its membership agreement. The First Cause of Complaint alleges that the Firm, acting through Day and Wood, breached its membership agreement with NASD by holding customer funds and securities, in violation of NASD Conduct Rule 2110. The Second Cause of Complaint alleges that the Firm, acting through Day and Wood, engaged in the securities business without maintaining minimum net capital, in violation of Exchange Act Rule 15c3-1 (“Net Capital Rule”) and NASD Conduct Rule 2110. The

Third Cause of Complaint alleges that the Firm, acting through Day and Wood, while holding customer funds and securities, failed to establish a Special Reserve Bank Account for the Exclusive Benefit of Customers, and failed to make computations of the amounts of funds required to be deposited in such an account, in violation of Exchange Act Rule 15c3-3 (“Customer Protection Rule”) and NASD Conduct Rule 2110. Finally, the Fourth Cause of Complaint alleges that Wood continued to work as a registered representative while his registration was deemed inactive for his failure to take the Regulatory Element of Continuing Education, in violation of NASD Membership and Registration Rule 1120(a) and NASD Conduct Rule 2110. Day and Day International are charged with permitting Wood’s violation of Rule 1120(a).

II. PROCEDURAL BACKGROUND

The Department filed the Complaint on December 9, 2002. Day International and Day filed an Answer on January 30, 2003, and admitted to Wood’s violation of failing to complete the Regulatory Element of Continuing Education. In response to the remaining three causes of action, they neither admitted nor denied the allegations. Day International and Day requested a hearing.

On January 2, 2003, Wood filed his Answer in which he denied all of the allegations in the Complaint. Wood asked that the Complaint be dismissed, but he did not specifically request a hearing.

The Hearing Officer ultimately set the case for hearing on August 12, 2003, in San Francisco before a hearing panel comprised of the Hearing Officer and two current members of NASD District 1 Committee. However, at the final pre-hearing conference on August 6, 2003, the Respondents stated that they did not intend to attend the hearing or

participate further in their defense. The Hearing Officer advised the Respondents that should they fail to appear they could be found in default, in which case the allegations in the Complaint could be taken as admitted. Then, following a discussion of their options, the Respondents waived their right to a hearing. Consequently, the Hearing Officer canceled the hearing and informed the Parties that the Hearing Panel would decide the case based upon the record. In addition, the Hearing Officer advised the Parties that they could supplement the record if they desired.

On August 7, the Department filed a request to supplement the record, which the Hearing Officer granted. The Hearing Officer set a deadline of August 29 for the Department to file any further papers in support of the Complaint and a deadline of September 19 for the Respondents to file responses. The Department filed a Supplemental Memorandum and the Declaration of Cliff Granger (“Decl.”), an NASD Compliance Examiner in NASD’s San Francisco office. Day International and Day did not submit any materials in their defense. On September 8, Wood filed a Reply to Department of Enforcement’s Supplemental Memorandum.

III. FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. The Respondents

According to Day’s Central Registration Depository (“CRD”) record, Day started in the securities industry in 1983.¹ In September 1988, he formed Day International Securities, which was a member of NASD from July 1989 until February 26, 2003.² Day

¹ Ex. C-2. (The Department submitted 38 exhibits with its Pre-Hearing Submissions and Exhibit 39 with Granger’s Declaration.)

² Ex. C-1.

held the position of President,³ and Wood held the positions of Vice President and compliance officer.⁴

While associated with Day International, Day was registered as an Investment Company and Variable Contracts Products Representative and as a Limited Principal—Investment Company and Variable Contracts Products.⁵ Both of Day’s registrations terminated effective January 13, 2003.⁶

Wood was registered as a General Securities Principal, a General Securities Representative, an Investment Company and Variable Contracts Products Representative, and an Investment Company and Variable Contracts Products Principal at Day International.⁷ His registrations as an Investment Company and Variable Contracts Products Representative and an Investment Company and Variable Contracts Products Principal terminated effective November 1, 2002, and his registrations as a General Securities Principal and a General Securities Representative terminated effective November 22, 2002.⁸

At all times relevant to the allegations in the Complaint, Day and Wood were the only two registered persons at Day International.⁹ Wood was responsible for financial and

³ *Id.*, at 2.

⁴ Ex. C-34, at 2.

⁵ Ex. C-2, at 3.

⁶ *Id.*

⁷ Ex. C-3, at 3.

⁸ *Id.*

⁹ Ex. C-34, at 2.

operations matters.¹⁰ Neither is currently registered with NASD or employed in the securities industry.

B. Membership Agreement and Net Capital Violations

Day International was admitted to NASD membership as a \$5,000 broker-dealer pursuant to the Net Capital Rule, Exchange Act Rule 15c3-1. Accordingly, pursuant to Rule 15c3-1(a)(2)(vi), Day International could not “receive ... or hold funds or securities for ... customers [or] carry accounts of, or for, customers.” In order to engage in these activities, the Net Capital Rule requires broker-dealers to have a minimum net capital of \$250,000.¹¹

The Net Capital Rule also requires (with some exceptions not relevant here) any broker-dealer that affects more than ten transactions in any one calendar year for its own investment account to maintain a net capital of not less than \$100,000.¹²

The undisputed evidence shows that, at various times, the Respondents violated the Net Capital Rule and their Membership Agreement, as discussed below.

In early 2001, NASD staff received a telephone call from the Firm’s independent accountant, who informed the staff that Day International was holding customer funds.¹³ Based on this information, on February 12, 2002, NASD opened a special financial examination of Day International.¹⁴ During the examination, NASD staff discovered that

¹⁰ Decl. ¶ 4. The Membership Agreement granted the Firm an exemption from the requirement to qualify a Financial and Operations Principal.

¹¹ Rule 15c3-1(a)(2)(i).

¹² Rule 15c3-1(a)(2)(iii)(B).

¹³ Decl. ¶ 6.

¹⁴ *Id.*

Day International maintained two securities accounts at Merrill Lynch—a general account, titled “Day International Securities” (“General Account”), and a trust account, titled “Day International Securities Trust Account” (“Trust Account”).¹⁵

The staff obtained and analyzed the following documents for the Firm’s two accounts with Merrill Lynch: (1) account statements for the General Account for January and February 2000; (2) monthly account statements for the Trust Account for the year 2000; (3) the Receipts and Disbursements Blotter for the Trust Account for the year 2000; (4) the General Ledgers for each account for the year 2000; (5) the Monthly Trial Balances for each account for the year 2000; (6) the Monthly Balance Sheets for each account for the year 2000; (7) the Monthly Income Statements for each account for the year 2000; and (8) the General Account Receipts and Disbursements Blotter for January through May 2000.¹⁶ From its analysis, the staff determined that the Firm was holding customer funds and securities in the two accounts for the following periods: (1) December 29, 1999, to June 23, 2000; (2) July 21, 2000, to August 8, 2000; (3) August 11, 2000, to October 11, 2000; and (4) December 15, 2000, to December 22, 2000.¹⁷

The staff prepared net capital computations for the Firm, taking into consideration the fact that it was holding customer funds and securities for the foregoing periods. The Department’s net capital computations reflect that on January 3, February 1, March 1, April 3, May 1, June 1, August 1, and October 2, 2000, the Firm conducted a securities

¹⁵ *Id.* at ¶ 9.

¹⁶ Decl. ¶¶ 9–13.

¹⁷ *See Id.* at ¶¶ 14–23.

business without maintaining a minimum net capital of \$250,000, as required by Exchange Act Rule 15c3-1(a)(2)(i).¹⁸

In addition, the Firm's records reflected that the Firm had conducted more than ten transactions in its proprietary account by the end of February 2000.¹⁹ Thus, the Firm was required thereafter to maintain a minimum net capital of \$100,000 regardless of whether it was holding customer funds or securities. The Department's net capital computations show that on July 3, November 1, and December 1, 2000, the Firm conducted a securities business without maintaining a minimum net capital of \$100,000, as required by Exchange Act Rule 15c3-1(a)(2)(iii)(B).

Finally, the staff recomputed the Firm's net capital requirements to disallow the customer funds the Firm held in the General Account because the Firm did not have a "PAIB"²⁰ agreement with Merrill Lynch, which is required under Exchange Act Rule 15c3-3 for these assets to be treated as allowable for the purposes of the Firm's net capital requirements.²¹ The staff also included the funds and securities held in the Trust Account, which the Firm had failed to include in any of its net capital computations.²² With these adjustments, the Department's net capital computations show that the Firm conducted a securities business on January 2 and February 1, 2001, without maintaining a minimum net capital of \$5,000.

¹⁸ Ex. C-39 reflects that the Firm engaged in the securities business on each date the Department alleges the Firm failed to maintain the required minimum net capital.

¹⁹ Decl. at ¶ 26.

²⁰ "PAIB" refers to a proprietary account of an introducing broker-dealer.

²¹ See Notice to Members 98-99.

²² Decl. ¶ 28.

Accordingly, the Hearing Panel finds that the Respondents breached the Firm's Membership Agreement, thereby violating NASD Conduct Rule 2110. The Hearing Panel further finds that the Firm through Wood violated the Net Capital Rule, Exchange Act Rule 15c3-1, and the Firm and Wood violated NASD Conduct Rule 2110, as alleged in the second cause of the Complaint. There is insufficient evidence, however, to find Day responsible for the net capital violations. Wood prepared the Firm's net capital computations during the subject period,²³ and there is no evidence that Day involved himself in that process.

C. Customer Protection Rule Violations

The Customer Protection Rule requires broker-dealers that receive, acquire, or hold customer funds or securities to establish a Special Reserve Bank Account for the Exclusive Benefit of Customers. Day International did not maintain such an account, yet it held customer funds and securities in the two Merrill Lynch accounts for the following periods: (1) December 29, 1999, to June 23, 2000; (2) July 21, 2000, to August 8, 2000; (3) August 11, 2000, to October 11, 2000; and (4) December 15, 2000, to December 22, 2000. Both Day and Wood participated in the receipt of customer securities and funds and their deposit into the Merrill Lynch accounts rather than a special reserve account, as required by Exchange Act Rule 15c3-3(e)(1). Accordingly, the Hearing Panel finds that the Respondents violated the Customer Protection Rule and NASD Conduct Rule 2110, as alleged in the third cause of Complaint.

²³ Decl. ¶ 31; Ex. C-38.

D. Continuing Education Violation

The staff determined, and the Respondents conceded, that Wood's registration had automatically become inactive on August 6, 2000, because he did not complete the Regulatory Element of Continuing Education under NASD's Membership and Registration Rule 1120(a).²⁴ Nevertheless, in violation of Rule 1120(a)(1), Day and the Firm permitted Wood to continue to perform duties as a registered person. At a minimum, Wood continued to review the Firm's records and prepare the Firm's net capital computations while his registrations were inactive.²⁵ The Hearing Panel therefore finds that the Respondents violated Rules 1120(a) and 2110, as alleged in the fourth cause of the Complaint.

IV. SANCTIONS

A. Membership Agreement Violation

The NASD Sanction Guidelines ("Guidelines") recommend that, for violating a Member Agreement, a fine ranging from \$2,500 to \$50,000 be imposed on the firm and the responsible individuals.²⁶ In cases involving a serious breach of a restrictive agreement, the Guidelines recommend in addition that the firm and the responsible individuals be

²⁴ Decl. ¶ 31; Ex. C-3, at 4. Rule 1120(a)(1) provides that an NASD member shall not "permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person unless such person has [completed the Regulatory Element of the continuing education requirements]." Rule 1120(a)(2) provides that "any registered persons who have not completed the Regulatory Element within the prescribed time frames will have their registrations deemed inactive ... and shall cease all activities as a registered person and is prohibited from performing any duties and functioning in any capacity requiring registration."

²⁵ Decl. ¶ 31; Ex. C-21; Ex. C-38.

²⁶ NASD Sanction Guidelines 51 (2001 ed.).

suspended for up to two years. And, in egregious cases, the Guidelines suggest expelling the firm and barring the responsible individuals.²⁷

Here, the Department recommended that the Respondents be fined \$10,000, jointly and severally. In making this recommendation, the Department described the breach of Day International's Membership Agreement as material, placing customer funds and securities at risk.²⁸ The Department also noted that the Firm evaded both the Net Capital Rule and the Customer Protection Rule.

Generally, the Hearing Panel agrees with the Department's assessment of the gravity of the Respondents' violation. In addition, however, the Hearing Panel notes that the Respondents breached a restriction on the Firm's activities, a Principal Consideration under the Guidelines.²⁹ Moreover, the Respondents unsuccessfully attempted to modify the restriction so that the Firm could provide custodian services of qualified accounts.³⁰ The Hearing Panel considered this an aggravating factor because it tended to show that the Respondents' violation was willful,³¹ indicating that the breach was not inadvertent. The Hearing Panel believes that these factors warrant more severe sanctions than those the Department recommended. Accordingly, the Hearing Panel fines the Respondents \$10,000, jointly and severally, and suspends each Respondent in all capacities for 30 business days for their violations of the Membership Agreement and NASD Conduct Rule 2110.

²⁷ *Id.*

²⁸ Supplemental Mem. 4.

²⁹ Guidelines 51, Principal Consideration No. 2.

³⁰ *See* Ex. C-5; Ex. C-6.

³¹ Guidelines 51, Principal Consideration No. 3.

B. Net Capital Violation

For net capital violations, the Guidelines recommend a fine of \$1,000 to \$50,000, and a suspension for up to 30 business days.³² In egregious cases, the Guidelines suggest a lengthier suspension or an expulsion of the firm and a bar for the responsible individual.³³

Here, the Department recommended that the Hearing Panel fine the Respondents \$20,000, jointly and severally, and suspend them for 30 business days. In support of its recommendation, the Department points out that there were 14 violations over a one-year period. In addition, looking to the principal considerations in determining sanctions set forth in the Guidelines, the Hearing Panel noted that Wood did not take responsibility for his misconduct or claim that he reasonably relied on competent legal or accounting advice. On the other hand, the Department does not argue that Wood intentionally violated the Net Capital Rule, and the record does not support such a finding. Accordingly, Wood and the Firm are fined \$20,000, jointly and severally, and suspended in all capacities for 30 business days for their violations of the Net Capital Rule.

C. Customer Protection Rule Violation

For violations of the Customer Protection Rule, the Guidelines recommend a fine of \$1,000 to \$50,000, and a suspension for up to 30 business days.³⁴ In egregious cases, the Guidelines suggest consideration of an expulsion of the firm and a bar for the responsible individuals.³⁵

³² Guidelines 33.

³³ *Id.*

³⁴ *Id.* at 32.

³⁵ *Id.*

Here, the Department recommends that the Respondents be fined \$20,000, jointly and severally, and that they be suspended in all capacities for an additional 30 business days. The Department argues that the suspensions are appropriate because the Respondents placed customer funds at risk although there was no actual customer loss associated with the violation. The Department cites no other aggravating factors.

The Hearing Panel agrees with the Department's recommendation. Accordingly, the Respondents are fined \$20,000, jointly and severally, and suspended in all capacities for 30 business days for their violation of the Customer Protection Rule.

D. Continuing Education Violation

The Guidelines recommend a fine of \$1,000 to \$5,000 for an individual's violation of NASD's continuing education rule.³⁶ In addition, the Guidelines recommend that a firm be fined \$2,500 to \$20,000 for permitting an individual to function while his registration was inactive.³⁷

The Department recommended that the Respondents be fined \$3,000, jointly and severally, because there is no evidence that the violation was intentional although Wood functioned for five months while his registrations were inactive. The Hearing Panel agrees with the Department's assessment that the evidence fails to show a willful violation of the rule. However, each Respondent bore responsibility for compliance with the requirements of Membership and Registration Rule 1120(a). Accordingly, the Respondents are each fined \$3,000 for their violation of Membership and Registration Rule 1120(a) and NASD Conduct Rule 2110.

³⁶ *Id.* at 49.

³⁷ *Id.*

V. ORDER

Day International, Day, and Wood are fined \$10,000, jointly and severally, and suspended for 30 business days in all capacities for breaching Day International's Membership Agreement, in violation of NASD Conduct Rule 2110.

Day International and Wood are fined \$20,000, jointly and severally, and suspended for 30 business days in all capacities for engaging in securities transactions while failing to maintain minimum net capital, in violation of Exchange Act Rule 15c3-1 and NASD Conduct Rule 2110.

Day International, Day, and Wood are fined \$20,000, jointly and severally, and suspended for 30 business days in all capacities for failing to establish a Special Reserve Bank Account for the Exclusive Benefit of Customers, in violation of Exchange Act Rule 15c3-3(e)(1) and NASD Conduct Rule 2110.

Day International, Day, and Wood are fined \$3,000 each for their violations of the Regulatory Element of NASD Membership and Registration Rule 1120(a) and NASD Conduct Rule 2110.

The foregoing suspensions shall run consecutively.

In addition, the Respondents are jointly and severally assessed a \$750 administrative fee.

These sanctions shall become effective on a date set by NASD, but not sooner than 30 days after this decision becomes the final disciplinary action of NASD, except: if this decision becomes NASD's final disciplinary action, the suspensions shall become effective as follows: Day's suspension shall begin with the opening of business on Monday, March 1, 2004, and end at the close of business on May 24, 2004; and Day International's and

Wood's suspensions shall begin with the opening of business on Monday, March 1, 2004, and end at the close of business on July 7, 2004.³⁸

Andrew H. Perkins
Hearing Officer
For the Hearing Panel

Copies to:

Douglas Conant Day (by FedEx, next day delivery, and first-class mail)
Day International Securities (by FedEx, next day delivery, and first-class mail)
Ronald Winston Wood (by FedEx, next day delivery, and first-class mail)
David A. Watson, Esq. (by first-class and electronic mail)
Rory C. Flynn, Esq. (by first-class and electronic mail)

³⁸ The Hearing Panel has considered all of the arguments of the parties. They are rejected or sustained to the extent they are inconsistent or in accord with the views expressed herein.