NASD REGULATION, INC.
OFFICE OF HEARING OFFICERS

DEPARTMENT OF ENFORCEMENT,	:	
Complainant,	:	Disciplinary Proceeding No. C9A000038
v.	:	
	:	**HEARING PANEL DECISION**
JEFFREY L. FARLEY (CRD #1891240)	:	Hearing Officer - DMF
Lutherville, MD	:	October 2, 2001
Pikesville, MD	:	
Respondent	:	

Respondent violated NASD Rule 2110 by receiving and using for his own benefit funds taken from the account of his employer. Respondent is barred from associating with any member firm in any capacity.

Appearances

David F. Newman, Esq., Regional Counsel, Philadelphia, PA (Rory Flynn, Esq., Washington, DC, Of Counsel) for the Department of Enforcement.

Dana N. Pescosolido, Esq., Baltimore, MD, for respondent.

DECISION

Procedural History

The Department of Enforcement filed a Complaint on April 12, 2001, charging that respondent Jeffrey L. Farley violated NASD Rule 2110 through "wrongful use of converted funds." Farley answered the Complaint, admitted he violated Rule 2110, and asked for a hearing on sanctions. A Hearing Panel composed of a Hearing Officer and two current members of the District Committee for District 9 held such a hearing on July

25, 2001, at which Farley and RB, an officer of Farley's former employer, testified. Enforcement also introduced two exhibits (CX 1-2).[1]

Facts

There was no dispute about the relevant facts. Farley became associated with PSA Equities, Inc. in 1997. PSA Equities is part of PSA Financial Center ("PSA"), a "diversified financial services company," which also includes a fee-based money management business and an insurance business.

PSA Equities submitted a Form U-4 on Farley's behalf, and he became registered with the NASD as a General Securities Representative. But, apparently because it was investigating Farley's activities at his prior member firm, the State of Maryland did not approve Farley's registration as a General Securities Representative. Because PSA Equities is located in Maryland, Farley could not function as a registered representative without Maryland's approval. Maryland did, however, approve a limited registration for Farley, under which Farley was limited to "marketing PSA's money management services, not giving investment advice." In this role, "Mr. Farley's task was to motivate and assist the sales people who were licensed and/or interested in marketing capital management services for PSA. He also was instrumental in developing marketing pieces … to use in a situation where the salesman was trying to sell capital management services." Farley continued to perform these activities until he was terminated by PSA in June 1999. His NASD registration with PSA Equities was terminated as of June 9, 1999. (CX 1; Tr. 19-20, 23-24, 26, 55.)

[1] The Hearing Officer who presided at the hearing subsequently left the Office of Hearing Officers and a new Hearing Officer was appointed. The findings and conclusions set forth below reflect the determinations of the original Hearing Panel, including the Hearing Officer, as a result of the Panel's deliberations after the hearing. Based upon a complete and careful review of the entire record, the new Hearing Officer concurs in those determinations.

While he was working at PSA, Farley became romantically involved with SL, who was President and Chief Compliance Officer of PSA Equities. PSA officials were aware of their relationship and consented to it, perhaps because, since Farley was not able to function as a registered representative, SL did not supervise him. (Tr. 31-32, 43, 58-59.)

At some point, SL began taking money belonging to PSA Equities for her own use. The record does not establish when this began or how much she took. Farley denies that he was aware that SL was taking PSA Equities' funds, and there is no allegation or evidence that he was. On March 9, 1999, however, SL transferred $8,240 from a PSA Equities' firm account to Farley's personal securities account at PSA Equities. The next morning, Farley checked his account, discovered the additional funds, and immediately discussed this with SL. She disclosed to Farley that she had improperly transferred the funds to his account from PSA Equities. Farley says he told SL, "I don't want it, take it back. And I begged and urged her to, and she would not." According to Farley, SL said she could not reverse the transaction "because they're looking at me for several different issues and I can't bring attention to myself and I can't be moving money around."[2] (Tr. 58-59, 66-67, 75, 78.)

According to Farley, "I had a mental battle, do I turn her in, do I pay it back, what do I do, because she's definitely going to get fired if I turn her in. But I cared about her, I mean I was in a real pickle, I didn't know what to do, so I didn't do anything." (Tr. 67.)

[2] This testimony is not entirely credible. Farley said SL made these comments to him at 2:00 a.m. the day after she transferred the funds to his account. If SL believed she was under scrutiny and felt she could not move money, it is unlikely she would have transferred funds to Farley's account a few hours earlier; on the other hand, if she felt free to move the money into his account, there is no apparent reason why she should have been afraid to put it back where it belonged. In any event, the Panel did not find Farley's testimony in this regard, whether or not true, to be significant in determining the appropriate sanction.

So, although he knew the money belonged to PSA Equities, Farley kept it. He testified that, from the time he knew the funds were in the account, his intention was "[o]ne hundred percent to pay it back somehow, some way." (Tr. 68.) But he did not segregate PSA Equities' funds until he could do that. Instead, he used those funds, as well as his own funds in his account, for investments and to pay his living expenses.[3] (Tr. 60-61.)

Eventually, another PSA employee became suspicious of SL and conducted an investigation, which led to the discovery that SL had taken PSA Equities' funds for her own use, and PSA terminated her. Farley testified that PSA officials did not confront him about the funds that SL had transferred to his account until several weeks after SL's termination.[4] During the intervening period, Farley did not disclose to PSA officials that SL had transferred funds to his account. He testified this was because he no longer had enough money to repay PSA, having either spent the funds that SL placed in his account or lost them in bad investments. When confronted, Farley admitted that SL had transferred the funds to his account, and after he was terminated he did repay PSA $8,240, plus interest. (Tr. 26-28, 39, 40, 64.)

Discussion

The NASD has jurisdiction over Farley for purposes of this proceeding, pursuant to Article V, Section 4 of the NASD's By-Laws. When he received and used PSA Equities' funds, he was associated with that firm and registered with the NASD, even though he was not functioning as a registered representative. And although he is not now

[3] Farley testified that, at the time, he had no bank account, so he used the securities account for all his living expenses, as well as investing. (Tr. 60.)

[4] RB testified he thought the firm confronted Farley within a day or two after it terminated SL (Tr. 42), but, in general, RB's testimony was vague concerning the sequence of events, and therefore the Panel accepts Farley's testimony that several weeks elapsed after SL's termination before the firm confronted him about the funds she had transferred to his account.

associated with a member firm, the Complaint was filed within two years of the effective date of termination of his registration with PSA Equities.

Farley admitted that by receiving, retaining and using the PSA Equities funds that SL transferred to his account, he violated Rule 2110, which requires members and associated persons to "observe high standards of commercial honor and just and equitable principles of trade." The only issue before the Hearing Panel was what sanctions were appropriate for this violation.

Enforcement urged the Hearing Panel to permanently bar Farley from associating with any member firm in any capacity, relying on the current NASD Sanction Guidelines for "conversion." Those Guidelines recommend that an adjudicator "[b]ar respondent regardless of amount converted." NASD Sanction Guidelines, p. 42 (2000 ed.). In contrast, Farley argued that, although his conduct violated Rule 2110, it amounted to "improper use of funds," rather than "conversion." For improper use not amounting to conversion, the current Guidelines recommend that an adjudicator "[c]onsider a bar [but] [w]here … mitigation exists, consider suspending respondent in any or all capacities for a period of six months to two years …." Farley, however, urged the Hearing Panel to apply older NASD Guidelines, in which the recommended sanctions for improper use not amounting to conversion were "suspension of Respondent in all capacities for six months to two years …, requalification by examination and proof of restitution." NASD Sanction Guidelines p. 13 (1996 ed.).

The Hearing Panel applied the current Guidelines. In Notice to Members 01-27 (April 2001), the National Adjudicatory Council explained, "The revised Sanction Guidelines supercede guidelines previously published by the NAC and referenced in

prior NASD Notices to Members. The revised Sanction Guidelines are effective as of April 10, 2001, and apply to all actions as of that date, including pending disciplinary actions." This is such a proceeding. [5]

Next, the Panel concluded that, for purposes of applying the Guidelines, Farley's conduct amounted to conversion. The Guidelines describe conversion as "an intentional and unauthorized taking of and/or exercise of ownership over property by one who neither owns the property nor is entitled to possess it." Farley argued that this is a "loose definition" that does not precisely comport with the common law legal standards for conversion. (Tr. 105.) But the Hearing Panel's task is to apply the Sanction Guidelines, not the common law. Regardless whether the language in the Guidelines tracks the common law, it manifestly describes the type of conduct that the Guidelines expect adjudicators to sanction as "conversion." Farley admits that he intentionally exercised ownership rights over PSA Equities' funds, even though he knew he neither owned the funds, nor had any right to them. Thus, the Hearing Panel concluded that Farley's misconduct should be sanctioned as "conversion."

Furthermore, even if Farley's misconduct were characterized as "improper use," rather than "conversion," a bar is appropriate under the Guidelines. Farley emphasized that he did not take the money from PSA Equities' account; it merely appeared in his account as a result of action by SL that, Farley says, he did not request, authorize or know of in advance. Those facts would carry weight if Farley had promptly returned the money; instead, knowing that it belonged to PSA Equities, he nevertheless kept the

[5] Moreover, Farley relies on provisions of the 1996 Sanction Guidelines, which were superceded by new Guidelines in 1998, before Farley's misconduct occurred. Thus, even if the Panel were not inclined to apply the 2001 Guidelines, it would apply the 1998 Guidelines, which, like the 2001 Guidelines, recommended that, for improper use not amounting to conversion, the adjudicator "[c]onsider a bar [except where] mitigation exists." NASD Sanction Guidelines, p. 34 (1998 ed.).

money and spent it. This is precisely the sort of improper use of funds for which the Guidelines envision a bar as the appropriate sanction. The observations of the National Adjudicatory Council in DOE v. Foran, 2000 NASD Discip. LEXIS 8 (Sept. 1, 2000), which also involved a respondent who used firm funds for his own purposes, are applicable to this case, as well:

> As the SEC has acknowledged, "the securities business presents a great many opportunities for abuse and overreaching, and depends heavily on the integrity of its participants." … [Respondent's] misconduct strikes at the heart of Rule 2110 – unethical behavior – and the sanctions that we impose must recognize the severity of his misconduct.

The Hearing Panel found nothing to mitigate the seriousness of Farley's misconduct.[6] Farley testified he "was in a real pickle" because he did not want to get SL fired, but that is simply another way of saying he decided to protect his girlfriend, who had admitted stealing the funds from their employer, at the employer's expense. The desire to protect a wrongdoer, even a girlfriend, is not a mitigating circumstance. Similarly, the fact that the funds did not belong to customers is not mitigating; it was just as unethical for Farley to keep and spend firm funds as customer funds.[7] And the Panel did not find Farley's repayment of the funds after his actions were discovered and he was terminated to be mitigating. Instead, Farley should have "voluntarily and reasonably attempted, prior to detection and intervention, to pay restitution or otherwise remedy the misconduct." Sanction Guidelines, at 10 (emphasis added).

---

[6] Farley's conduct was even more egregious than Foran's, because Foran believed he had a right to the firm funds that he took, while Farley admits that he knew from the outset he had no right to PSA Equities' funds.

[7] See Foran, supra ("Foran also cited as a mitigating factor that his misconduct did not result in customer harm. We do not find this to be mitigating.")

Other facts tend to aggravate, rather than mitigate, the seriousness of Farley's misconduct. When SL transferred the funds into his account, Farley was under investigation by the New York Stock Exchange for activities at his prior firm. (Tr. 61.) Subsequently, he entered into a settlement with the NYSE under which he was disciplined for making unsuitable recommendations to customers. (CX 2.) Although the NYSE proceeding did not involve conversion or misuse of funds, the pending investigation should have made Farley acutely aware of his obligations as an associated person. Indeed, Farley testified that he "was grateful that PSA … saw the benefits of having me on board and would work with me and make sure that I was squeaky clean, and it was a new lease on life and I knew that I had to keep a clean record to get back into the business." (Tr. 65.) In spite of this, Farley elected to keep and spend PSA funds to which he knew he was not entitled.

Finally, while he admits he violated Rule 2110, Farley has not fully acknowledged his responsibility for his misconduct. He testified that, because he did not take the money directly, "in my mind then and certainly not now, do I think that I did the same thing that SL did." (Tr. 77.) According to Farley, "I didn't steal any money … I'm just a victim of some extremely bizarre circumstances really …." (Tr. 84.)

The Hearing Panel did not see Farley as a victim. On the contrary, when PSA Equities' funds appeared in his account, he made a conscious decision to keep the money, and he spent it for his own purposes. On balance, the Panel concludes that Farley would pose a risk to firms and customers if he were allowed to return to the industry.

Conclusion

The Hearing Panel finds that respondent Jeffrey L. Farley violated Rule 2110 by receiving and using for his own purposes funds belonging to the member firm with which he was associated. For the violation, Farley is barred from associating with any member firm in any capacity. In addition, he is assessed costs in the amount of $1,826.40, which includes an administrative fee of $750 and hearing transcript costs of $1,076.40. The bar shall become effective immediately upon this decision becoming the final disciplinary action of the Association. The costs shall be due and payable at a time set by the Association, but not less than 30 days after this decision becomes the final disciplinary action of the Association.[8]

HEARING PANEL

By: _____
David M. FitzGerald
Hearing Officer

Copies to:

Jeffrey L. Farley (via overnight delivery and first class mail)
Dana N. Pescosolido, Esq. (via facsimile and first class mail)
David F. Newman, Esq. (electronically and via first class mail)
Rory C. Flynn, Esq. (electronically and via first class mail)

[8] 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.