

BEFORE THE NATIONAL ADJUDICATORY COUNCIL

NASD REGULATION, INC.

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| In the Matter of the Association |
| of                               |
| X                                |
| as a                             |
| General Securities Principal     |
| with                             |
| The Sponsoring Firm              |

**Redacted Decision**

Notice Pursuant to  
Rule 19h-1  
Securities Exchange Act  
of 1934

SD99008

On December 10, 1997, a member firm ("the Sponsoring Firm" or "the Firm"), completed an MC-400 application ("Application") to permit X<sup>1</sup>, a person subject to a statutory disqualification, to associate with the Firm as chairman of its Board of Directors and also as a general securities principal. The Application also requests permission for X to assume ownership of the Sponsoring Firm's. In November 1998, a subcommittee of the Statutory Disqualification Committee of NASD Regulation, Inc. ("NASD Regulation") held a hearing on the matter. X appeared and was accompanied by his proposed supervisor ("the Proposed Supervisor"). BK appeared on behalf of the Department of Member Regulation ("Member Regulation").

X's statutory disqualification arose from a 1976 Offer of Settlement in an administrative proceeding before the Securities and Exchange Commission ("Commission"). Pursuant to the Order of Proceedings and the Offer of Settlement in that matter, the Commission found that X and Firm A, a firm of which he was part owner, among others, willfully violated and willfully aided and abetted violations of Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and willfully aided and abetted violations of Section 15(b) of the Securities Exchange Act and Rule 15b3-1 thereunder. The Commission alleged that X had engaged in fraudulent mark-ups in securities transactions.

The Commission ordered that the registration of Firm A be suspended for six months and that its registration be withdrawn after the suspension. The principals of that firm, including X, were suspended from associating with any broker/dealer, investment adviser, or investment company in any capacity for

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<sup>1</sup> 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.

60 days and barred from associating with a broker/dealer, investment adviser or investment company in a supervisory or proprietary capacity with a right to reapply for such association after 18 months from the date of that order.

As a result of the 1976 Commission Order, Firm A merged with another broker/dealer to form Firm B, an NASD member firm. Pursuant to his Offer of Settlement, X's ownership interest in Firm B was placed in a voting trust outside his control. In April 1979, the Commission granted X's request to associate with Firm B in a supervisory and proprietary capacity.<sup>2</sup> In accordance with the Commission's Order, X provided an affidavit to the Regional Office of the Commission stating that he had complied with the sanctions imposed by the Commission. He also provided an affidavit from Firm B that he was employed in a supervised capacity.<sup>3</sup>

After resigning from Firm B in November 1984, X was employed in the capacity of independent registered representative with Firm C (1984 through 1989), Firm D (1989 through 1997), and Firm E. (1997 through 1998) without any disciplinary or regulatory incidents.

In 1984, X filed an application with the National Futures Association to establish Firm E, a commodities firm, which was approved without restriction.<sup>4</sup> In August 1997, X established Firm F, a division of Firm E which was created to market discount futures trading services through the Internet. Firm F is registered with the National Futures Association as an introducing broker. Upon inquiry, the National Futures Association confirmed to Member Regulation that X has been associated without any disciplinary or regulatory incident.<sup>5</sup>

The Sponsoring Firm is organized as a private corporation owned by the Proposed Supervisor. The Sponsoring Firm was previously owned by Firm E, which was 100-percent owned by X. X transferred ownership of the Sponsoring Firm to the Proposed Supervisor when he learned that his statutory disqualification prevented his ownership without approval. The Sponsoring Firm became a member of the NASD in February 1998 and is engaged in a general securities business and discount brokerage. The Firm employs 65 registered representatives, 19 associated persons, and 26 registered general securities principals and has established 19 branch offices. The Sponsoring Firm proposes to employ X as chairman of its Board of Directors and as a general securities principal in its main office. As outlined by the Application, X will be active in establishing the Firm's strategic direction but not in directing its day-to-day operations.

The Sponsoring Firm proposes that the Proposed Supervisor supervise X. The Proposed

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<sup>2</sup> See Affidavit by X and Letter from Director, Division of Enforcement, Securities and Exchange Commission to Managing Director, Firm B (April 1979).

<sup>3</sup> See Letter from X to Securities and Exchange Commission (March 1979).

<sup>4</sup> Applicant and the National Futures Association have confirmed that X provided complete disclosure of the 1976 Commission Order to the National Futures Association in relation to his application to establish Firm E.

<sup>5</sup> See Letter from Document Research Supervisor, National Futures Association, to NASD Regulation, Inc. (February 1998).

Supervisor has been a general securities principal since September 1983 and a general securities representative since October 1978. X lent \$33,750 to the Proposed Supervisor in order to invest in a private company. The interest rate on the loan was 6 percent and the original term of the loan was two years, to conclude in March 1996. Since that time, the loan has been verbally and annually renewed at the same interest rate without reduction in the principal amount. The Proposed Supervisor also is currently employed by Firm E.

Member Regulation recommends that X's association with the Sponsoring Firm be approved with certain restrictions. Specifically, Member Regulation recommends that the Committee consider imposing the following conditions in connection with the approval of X's application:

1. X must conduct business on behalf of the Sponsoring Firm only from the office where the Proposed Supervisor is physically located, as represented in the MC-400 application;
2. The supervisory procedures of the Sponsoring Firm must be amended clearly to establish the Proposed Supervisor's responsibility to supervise X;
3. The specific steps for heightened supervision of X by the Proposed Supervisor must be written and incorporated into the Sponsoring Firm's written supervisory procedures;
4. For a 12-month period the heightened supervision of X by the Proposed Supervisor must include, at a minimum, review and approval of any transaction or other business on behalf of a the Sponsoring Firm customer whereby X serves as the Sponsoring Firm representative;
5. X is prohibited from assuming any primary responsibility or authority over any policies or procedures for setting mark-ups and mark-downs on securities;
6. X is prohibited from managing or supervising any aspect of Firm A's day-to-day operations or its employees; and
7. This approval is limited to X's acting in the capacity of a passive investor in Firm A.

Moreover, Member Regulation recommended that the Proposed Supervisor execute a loan agreement that the loan from X will be paid with a specified rate of interest and at a date certain. We note that X and the Proposed Supervisor subsequently memorialized their loan arrangement to the satisfaction of Member Regulation and the SD Committee.

### Discussion

As a threshold matter, the regulatory activity which forms the basis of X's statutory disqualification, while serious, occurred more than 22 years ago. Since that time, no self-regulatory agency or state securities regulatory agency has taken disciplinary or regulatory action against X. Moreover, we are unaware of any customer complaints or arbitrations filed against X. X has successfully run a commodities firm without incident and, in November 1997, passed the Series 24 examination.

X and the Sponsoring Firm have represented that, if approved, X will serve as chairman of the

Firm's Board of Directors, that he will direct the Firm's strategic planning, and that he will become the indirect full or partial owner of the Sponsoring Firm through his ownership of Firm E. They have also represented that he will not be designated as a supervisor of any of the Firm's day-to-day operations, and that he will not assume responsibility for setting the Firm's policies or procedures with respect to mark-ups and mark-downs without prior approval of NASD Regulation. X and the Firm have also agreed to seek prior approval from NASD Regulation, should they desire that X become the Firm's Chief Operating Officer.

Based upon these represented limitations, we conclude that it is in the public interest to allow the continued association of X in the securities industry through his association with the Sponsoring Firm. The Sponsoring Firm is directed to amend its supervisory procedures to establish the Proposed Supervisor as X's supervisor in X's capacities as both a general securities representative and also as a general securities principal. X was not statutorily disqualified as a general securities representative, but the Proposed Supervisor has agreed to review all order tickets for X's transactions for a 12-month period.

The Proposed Supervisor will also be required to supervise X in his capacity as a principal and as chairman of the Firm's Board of Directors by meeting with X at least four times each year, reviewing X's conduct and paperwork, and keeping a detailed record of those meetings. Regardless of the difficulty that the Proposed Supervisor may face in supervising an individual who may fairly be considered to be his boss, the Proposed Supervisor has voluntarily accepted responsibility for ensuring that X complies with all applicable securities laws, the rules of this Association, and the limitations imposed above.

We certify that X meets all applicable requirements for the proposed employment, that no familial relationship exists between him and the Proposed Supervisor, and that the Sponsoring Firm is not a member of any other self-regulatory organization.

Accordingly, in conformity with the provisions of SEC Rule 19h-1, the registration of X as a general securities principal associated with the Sponsoring Firm will become effective upon the issuance of an order by the Commission that it will not institute proceedings pursuant to Section 15A(g)(2) of the Act. The NASD is also seeking relief under Section 19(h) of the Act. This notice will serve as an application for such an order.

On Behalf of the National Adjudicatory Council,

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Alden S. Adkins  
Senior Vice President and General Counsel