

BEFORE THE NATIONAL ADJUDICATORY COUNCIL
FINANCIAL INDUSTRY REGULATORY AUTHORITY

In the Matter of the Association of X ¹ as an Associated Person with The Sponsoring Firm	Redacted Decision <u>Notice Pursuant to</u> <u>Section 19(d)</u> <u>Securities Exchange Act</u> <u>of 1934</u> <u>SD12002</u> Date: 2012
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I. Introduction

On June 13, 2011, the Sponsoring Firm submitted a Membership Continuance Application (“MC-400” or “the Application”) with FINRA’s Department of Registration and Disclosure. The Application seeks to permit X, a person subject to a statutory disqualification, to associate with the Sponsoring Firm in a non-registered capacity. In September 2011, a subcommittee (“Hearing Panel”) of FINRA’s Statutory Disqualification Committee held a hearing on the matter. X appeared at the hearing, along with the Sponsoring Firm’s counsel, Attorney 1, X’s Proposed Supervisor, and the Sponsoring Firm’s president, chief operating officer, and chief financial officer, Firm President. FINRA Employee 1, FINRA Attorney 1, and FINRA Attorney 2, 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

II. The Statutorily Disqualifying Event

In 2008, X was convicted of conspiracy and intent to distribute 100 kilograms

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 FINRA Rule 9524(a)(10), the Hearing Panel submitted its written recommendation to the Statutory Disqualification Committee. The Statutory Disqualification Committee considered the Hearing Panel’s recommendation and presented a written recommendation to the National Adjudicatory Council (“NAC”), in accordance with FINRA Rule 9524(b)(1).

(approximately 220 lbs.) or more of marijuana, a Class B Felony. X was sentenced to 30 months incarceration in a federal correctional facility. X was released from prison in September 2009 after serving 13 months of his sentence. X is on supervised release until March 2013.

X explained that he was diagnosed with Hodgkin's Lymphoma in 2004. Due to associated serious health problems, X's income as a technician for Company 1 was reduced significantly, and X and his family experienced severe financial difficulties while X recovered. In 2006 X learned through a friend of an opportunity to assist with unloading a truck filled with marijuana in exchange for \$5,000. X stated that "[t]he financial stress ultimately led to a disastrous decision and my participation in an illegal scheme." X, along with several other individuals, was arrested in August 2006.

III. Background Information

A. X

X associated with the Sponsoring Firm for several months in 2009 and 2010, when he performed clerical duties similar to those proposed in the Application. In June 2010, the Sponsoring Firm placed X on an unpaid leave of absence upon being informed by Member Regulation that X should not associate with the Sponsoring Firm while the Application was pending.³ X unsuccessfully attempted to qualify as a general securities representative in 2009 and 2010. He is not currently registered in any capacity and is working several construction jobs.

Other than the statutorily disqualifying criminal conviction, X was convicted in 1991 of unlawful possession of alcohol and paid a \$50 fine. In 1989, X was convicted of reckless damage to property for writing graffiti and was sentenced to 90 days conditional discharge. In 1987, X was arrested for attempted grand larceny and conspiracy while working as a stock boy. X testified that these charges were dropped. We are not aware of any additional disciplinary or regulatory proceedings, complaints, or arbitrations against X.

B. The Sponsoring Firm

The Sponsoring Firm became a FINRA member in August 2007. The Sponsoring Firm's MC-400 represents that it has one office of supervisory jurisdiction and one branch office. The Sponsoring Firm also represents that it employs 10 registered principals and 30 registered representatives, and the Sponsoring Firm's Rhinebeck, New York branch office operates as a

³ In March 2010, the Sponsoring Firm filed a Membership Continuance Application for X to associate with the Sponsoring Firm. Member Regulation recommended that the Chair of the Statutory Disqualification Committee, acting on behalf of the NAC, approve X's proposed association with the Sponsoring Firm without conducting a hearing pursuant to FINRA Rule 9523. This recommendation was rejected, and the Sponsoring Firm subsequently filed the Application, which is substantially similar to the March 2010 Membership Continuance Application.

broker's broker. The Sponsoring Firm also conducts a floor brokerage business for institutional customers.

The Sponsoring Firm's most recent examination was completed on July 28, 2011. An examination report has not yet been issued. The "exit meeting report" issued in connection with the examination noted five exceptions. The Sponsoring Firm disputed several of the exceptions and characterized the remaining exceptions as minor violations.

A 2009 Sales Practice and FINOP examination of the Sponsoring Firm resulted in a Cautionary Action. The Cautionary Action cited the Sponsoring Firm for the following deficiencies: utilizing an Option Exercise Assignment Allocation that had not been approved by FINRA; failing to maintain procedures to prevent the acceptance of NMS quotes that violate minimum pricing requirements; failing to adhere to procedures that address the prevention of trade-throughs when effecting manual transactions and supervisory post-review of such transactions; failing to provide FINRA with notice that it outsourced electronic storage media and was using a third-party vendor to maintain certain books and records; failing to establish an audit system for the Sponsoring Firm's electronic storage media; failing to address certain outsourcing arrangements in the Sponsoring Firm's written supervisory procedures ("WSPs"); failing to enforce the Sponsoring Firm's WSPs regarding the review of daily options transactions and to implement certain procedures relating to options; failing to demonstrate that the Sponsoring Firm provided for an independent test of its anti-money laundering program; and failing to reflect accurate time stamps on several options order memoranda. The Sponsoring Firm responded and stated that it had corrected the noted deficiencies.⁴

A 2005 Sales Practice cycle examination of the Sponsoring Firm resulted in a Cautionary Action with respect to violations of the following rules: NYSE Rule 345A (Continuing Education for Registered Persons), NYSE Rule 342(b) (Offices—Approval, Supervision and Control), NYSE Rule 342.13 (Acceptability of Supervisors), NYSE Rule 342.17 (Review of Communications with the Public), 342.23 (Internal Controls), NYSE Rule 401 (Business Conduct), NYSE Rule 401(b) (Business Conduct—Internal Certifications), NYSE Rule 472(c) (Written Procedures), NYSE Rule 472(i) (General Standards for All Communications), NYSE Information Memos, and SIPC By-Laws Art. 11 Sec. 4 (Display of an official SIPC symbol).

We are not aware of any other recent complaints, disciplinary proceedings, or arbitrations against the Sponsoring Firm.

IV. X's Proposed Business Activities and Supervision

The Sponsoring Firm proposes to employ X in a non-registered capacity, performing administrative duties. X's proposed responsibilities will include reviewing brokerage bills and trading tickets, calculating option volume contracts, and other back office duties and ministerial

⁴ In addition, FINRA issued, on behalf of NYSE Regulation, a Letter of Admonition in connection with the 2009 examination that cited the Sponsoring Firm for failing to maintain sufficient evidence to support several error transactions. The Sponsoring Firm responded and stated that it had corrected the noted deficiencies.

tasks. The Sponsoring Firm represents that X will not perform any type of sales function and will not have contact with customers, although X testified that he aspires to someday be a registered representative in the industry. The Sponsoring Firm also represents that X will receive an annual salary and will not receive any commission-based compensation.

The Sponsoring Firm proposes that X will be employed in the Sponsoring Firm's branch office located in Rhinebeck, New York, and that he will be supervised by the Proposed Supervisor. The Proposed Supervisor has been in the securities industry since 1995, and he registered as a general securities representative in 2004. The Proposed Supervisor qualified as a general securities principal in February 2007 and is registered in several other capacities. The Proposed Supervisor has been associated with the Sponsoring Firm since June 2009.

The record shows no disciplinary or regulatory proceedings, complaints, or arbitrations against the Proposed Supervisor.

Following the hearing, the Sponsoring Firm proposed the following revised heightened supervisory procedures:⁵

1. The written supervisory procedures for the Sponsoring Firm will be amended to state that the Proposed Supervisor is the primary supervisor responsible for X.
2. If the Proposed Supervisor is to be on vacation or out of the office for an extended period (a period greater than two (2) days), and if during such period there is no alternate interim Supervisor (with requisite Series 24 or other supervisory registration (excepting Employee 1))⁶ present at the branch office located at City 1, State 1, then in such event X will be required to take a leave of absence during such period. (Note: The Sponsoring Firm's City 1, State 1 based employee Employee 2 is scheduled to take the Series 24 examination on or before 2011. Upon Employee 2 successfully passing the Series 24 examination, he will act as X's interim Supervisor during periods of the Proposed Supervisor's absence from the City 1, State 1 office).
3. X will not act in a supervisory capacity.
4. X will be supervised by the Proposed Supervisor in the branch office located at City 1, State 1, which is not an Office of Supervisory Jurisdiction.

⁵ At the hearing, the Sponsoring Firm stated that several aspects of the heightened supervisory plan were still under consideration. The Hearing Panel therefore requested that the Sponsoring Firm provide for its consideration a post-hearing submission containing updated heightened supervisory procedures.

⁶ Firm Employee 1 is X's brother and is a registered representative at the Sponsoring Firm.

5. In keeping with X's position as a non-registered employee, he will not be permitted to accept any funds or securities from a client.
6. In keeping with X's position as a non-registered employee, he will have no involvement or access to the Sponsoring Firm's funds.
7. For the purposes of client communication, X will only be allowed to use an email account that is held at the Sponsoring Firm, with all emails being filtered through the Sponsoring Firm's email system.
8. The Proposed Supervisor will review X's incoming written correspondence (which would include email communications) upon its arrival and will review outgoing correspondence before it is sent. The Proposed Supervisor will keep a written record evidencing review and approval of all of X's correspondence, which will be kept segregated for ease of review during any SD examination.
9. The Proposed Supervisor will intermittently monitor 10% of X's conversations on a monthly basis and will keep a written record documenting such monitoring.
10. The Proposed Supervisor will observe X's work activities and administrative duties as well as any reports or records that X creates; the Proposed Supervisor will keep a written record evidencing such review, which will be kept segregated for ease of review during any SD examination.
11. All complaints pertaining to X, whether verbal or written, will be immediately referred to the Proposed Supervisor for review, and then to the Compliance Department. The Proposed Supervisor will prepare a memorandum to the files as to what measures he took to investigate the merits of the complaint and resolve the matter and he will document the outcome of the customer complaint. Documents pertaining to complaints will be kept segregated for ease of review.
12. For the duration of X's statutory disqualification, the Sponsoring Firm must obtain prior approval from FINRA Member Regulation if they wish to change X's responsible supervisor from the Proposed Supervisor to another person.
13. The Proposed Supervisor must certify quarterly (March 31st, June 30th, September 30th, and December 31st) to the Compliance Department of the Sponsoring Firm that he and X are in compliance with all of the above conditions of heightened supervision to be accorded X. The Proposed Supervisor will document his performance of these special supervisory

procedures by preparing and signing Compliance Checklists created by the Sponsoring Firm.

V. Member Regulation's Recommendation

Member Regulation recommends that the application be denied because, in its view: (1) X's disqualifying event is serious and recent, and he is still on supervised release; (2) the Sponsoring Firm's regulatory history, including preliminary findings from the 2011 examination, indicates that the Sponsoring Firm may not be able to adequately supervise X; (3) X's brother (Employee 2) is a large producer at the Sponsoring Firm and will work in the same office, which may adversely impact the Sponsoring Firm's supervision of X; and (4) X has other criminal incidents. In addition, at the hearing Member Regulation argued that X had improperly associated with the Sponsoring Firm for a period of time notwithstanding his statutory disqualification.

VI. Discussion

In reviewing this type of application, we consider whether the particular felony at issue, examined in light of the circumstances related to the felony, and other relevant facts and circumstances, creates an unreasonable risk of harm to the market or investors.⁷ We assess the totality of the circumstances in reaching a judgment about X's future ability to act in a manner that comports with FINRA's requirements for high standards of commercial honor and just and equitable principles of trade in the conduct of his business. In so doing, we recognize that the sponsoring firm has the burden of demonstrating that the proposed association is in the public interest despite the disqualification. *See Pedregon*, 2010 SEC LEXIS 1164, at *16 & n.17; *Continued Ass'n of X*, SD06002, slip op. at 5 (NASD NAC 2006), available at <http://www.finra.org/web/groups/industry/@ip/@enf/@adj/documents/nacdecisions/p036476.pdf> (redacted decision).

We examine the nature and gravity of the statutorily disqualifying misconduct, the time elapsed since its occurrence, the restrictions imposed, whether the person has engaged in any intervening misconduct, and the potential for future regulatory problems, as well as other unique circumstances in the application. 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.

⁷ *See Frank Kufrovich*, 55 S.E.C. 616, 625 (2002) (upholding FINRA's denial of a statutory disqualification applicant who had committed non-securities related felonies "based upon the totality of the circumstances" and FINRA's explanation of the bases for its conclusion that the applicant would present an unreasonable risk of harm to the market or investors); *see also Timothy P. Pedregon, Jr.*, Exchange Act Rel. No. 61791, 2010 SEC LEXIS 1164, at *20 & n.21 (Mar. 26, 2010) (stating that FINRA's "analysis goes beyond the circumstances relating to the felony, and also encompasses circumstances relating to the proposed association"); *Timothy H. Emerson, Jr.*, Exchange Act Rel. No. 60328, 2009 SEC LEXIS 2417, at *14 (July 17, 2009) (stating that FINRA "appropriately weigh[ed] all the facts and circumstances surrounding [the applicant's] felony conviction and [the firm's] proposed supervisory plan").

For the reasons set forth below, we conclude that X's participation in the securities industry will present an unreasonable risk of harm to the market or investors, and we therefore deny the Sponsoring Firm's Application to employ X.

First, we note that X recently was convicted of a serious crime. Although not securities-related, X's participation in an illegal scheme to distribute more than 220 pounds of marijuana casts doubt on his character and leads us to question his ability to act in a trustworthy and responsible manner in the securities industry. The Commission has consistently recognized that "[a] propensity for dishonest behavior is of particular concern in the securities industry, an industry that presents numerous opportunities for abuses of trust . . . [I]n order to ensure protection of investors, the NASD may demand a high level of integrity from securities professionals." *Kufrovich*, 55 S.E.C. at 627. Although X's proposed role at the Sponsoring Firm would be in a non-registered capacity, we remain troubled about the questions that X's recent felony conviction raise about his character and integrity, and we find that insufficient time has passed since the conviction to enable X to demonstrate that he can conduct himself in a responsible and compliant fashion in the securities industry.

Second, X remains subject to supervised release until March 2013. The Commission has expressly shared FINRA's concern in not allowing disqualified individuals serving probation to be associated with member firms. *See id.* at 627-28 ("We share the NAC's concern that Kufrovich remains on probation.")⁸ Although X is currently in compliance with the terms of his supervised release, more than one year remains under the terms of his release. Accordingly, we conclude that the nature and recency of X's conviction, and the pendency of his supervised release through March 2013, militate against allowing X's entry into the securities industry at this time.

Finally, the revised plan of heightened supervision, submitted by the Sponsoring Firm in response to a request from the Hearing Panel, continues to raise questions concerning X's supervision. For example, the revised plan proposes that X may be unsupervised for up to two days if the Proposed Supervisor is out of the office, and he may be supervised by an unnamed "alternate interim Supervisor" if the Proposed Supervisor is out for more than two days. *See Leslie A. Arouh*, Exchange Act Release No. 62898, 2010 SEC LEXIS 2977, at *50 (Sep. 13, 2010) (finding supervisory plan inadequate where, among other factors, proposed plan lacked adequate supervisory coverage when proposed supervisor was out of office). The revised plan also provides for a contingent alternate supervisor, Employee 2, who had not qualified as a general securities principal at the time the Sponsoring Firm submitted the revised plan. It is unclear whether Employee 2 has any supervisory experience. *See Pedregon*, 2010 SEC LEXIS 1164, at *27 (finding "troubling" the assignment of an unqualified backup supervisor in a proposed supervisory plan). In addition, although the Sponsoring Firm represented that X would

⁸ "A defendant on probation is not incarcerated, but he is subject to restrictions on his activity. . . . probation is a sentence in and of itself. . . . As an independent sentence, probation differs from supervised release, which is imposed only following a term of imprisonment." 3 Charles Alan Wright & Sarah N. Welling, *Federal Practice and Procedure* § 547 (4th ed. 2011). Probation and supervised release, however, are generally treated the same for purposes of violating, and revoking, their terms. *Id.* at 562.

not have any contact with customers, the plan contains provisions concerning communications with customers, incoming and outgoing written correspondence, and potential customer complaints. Further, the provision in the plan concerning the Proposed Supervisor's monitoring 10 percent of X's conversations casts additional doubt on the exact parameters of X's proposed duties at the Sponsoring Firm and whether the Sponsoring Firm has proposed an adequate plan to supervise X in performing those duties.

As we have previously stated, "[i]t is the applicant's burden to show how it will effectively supervise the statutorily disqualified person; it is not the burden of NASD to describe a program of effective supervision to the applicant." *Continued Ass'n of X*, SD06002, slip op. at 7. Under the circumstances presented, we are not persuaded that the Sponsoring Firm has structured an adequate plan of heightened supervision for X to ensure that he complies with applicable securities rules and regulations. *See generally Pedregon*, 2010 SEC LEXIS 1164, at *27 (holding that a supervisory plan for a statutorily disqualified individual must provide for stringent supervision).

VII. Conclusion

Accordingly, 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 associate with the Sponsoring Firm. We therefore deny the Application.⁹

On Behalf of the National Adjudicatory Council,

Marcia E. Asquith
Senior Vice President and Corporate Secretary

⁹ Other than those discussed herein, we reject all additional bases asserted by Member Regulation for denying the Application, and find that the recency and serious nature of X's felony conviction, the fact that X remains on supervised release, and the serious questions concerning the proposed heightened plan of supervision alone warrant the denial.