SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59125 / December 19, 2008

Admin. Proc. File No. 3-12941

In the Matter of the Application of

RONALD PELLEGRINO
825 Sudden Valley
Bellingham, WA 98229

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDING

Failure to Supervise

General manager of former member firm of registered securities association failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations and with association rules. Held, association's findings of violation and sanctions imposed sustained.

APPEARANCES:

Ronald Pellegrino, pro se.

Marc Menchel, Alan Lawhead, and Michael J. Garawski, for NASD.

Appeal filed: January 30, 2008
Last brief received: May 22, 2008

I.

Ronald Pellegrino, a former general securities principal of Metropolitan Investment Securities, Inc. ("MIS"), a former NASD member firm, appeals from NASD disciplinary action. 1/ NASD found that "Pellegrino failed to establish and maintain an adequate supervisory system" at MIS in violation of NASD Rules 3010 and 2110. NASD barred him from serving in a principal capacity. 2/ We base our findings on an independent review of the record.

II.

This case concerns Pellegrino's liability for supervisory failures in connection with sales by MIS registered representatives of securities issued by two MIS affiliates, Metropolitan Mortgage and Securities, Inc. ("Metropolitan") and Summit Securities, Inc. ("Summit"). Although Metropolitan's and Summit's precarious financial position rendered their securities highly risky, MIS registered representatives routinely recommended and sold them to MIS customers seeking conservative investments. NASD found Pellegrino responsible for MIS's inadequate supervision of its sales force, which led to systematic abusive sales practices by the registered representatives and ultimately substantial losses by MIS customers. 3/

1/ On July 26, 2007, the Commission approved a proposed rule change NASD filed to amend its Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. See Securities Exchange Act Rel. No. 56148 (July 26, 2007), 91 SEC Docket 522. Because the disciplinary action taken here was instituted before that date, we continue to use the designation NASD.

2/ NASD Conduct Rule 3010 imposes supervisory requirements on NASD members. NASD Conduct Rule 2110 requires that members "observe high standards of commercial honor and just and equitable principles of trade." A violation of any NASD Conduct Rule, such as Conduct Rule 3010, also constitutes a violation of Rule 2110. Robert E. Strong, Exchange Act Rel. No. 57426 (Mar. 4, 2008), 92 SEC Docket 2875, 2887.

3/ MIS consented to findings that it, acting through its registered representatives, made unsuitable recommendations and misleading sales presentations in violation of NASD Rules 2310 and 2110, among other NASD rule violations. MIS was censured, fined $500,000, and ordered to pay $2.8 million in restitution.

A. Background

1. MIS, Metropolitan, and Summit

Metropolitan established MIS in 1979 for the purpose of selling its securities. MIS subsequently became a subsidiary of Summit, which was itself a Metropolitan subsidiary. The main offices of MIS, Metropolitan, and Summit shared the same office building. Metropolitan determined the number of MIS employees and was involved in their hiring and firing. MIS derived the majority of its revenues from the sales of Metropolitan and Summit securities. MIS was the primary, if not sole, vehicle through which Metropolitan and Summit offered and sold their securities to the public. 4/

Metropolitan and Summit offered to the public debentures, investment certificates, and preferred stock (collectively, the "Proprietary Products"). The Proprietary Products "were the majority" of what MIS's registered representatives sold. One representative testified that the "main securities business that [MIS] emphasized was the [P]roprietary [P]roducts," and others agreed that selling the Proprietary Products was MIS's primary mission and "main focus."

At the time Pellegrino joined MIS, C. Paul Sandifur, Jr. was MIS's president and chief executive officer; Reuel Swanson, MIS's chief compliance officer; and Al Olsen, an assistant vice president and supervisory principal. 5/ Sandifur, whose father founded Metropolitan, also

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4/ Pellegrino stipulated to this fact as part of a series of stipulations he executed prior to the hearing in this proceeding, and the record evidence confirms it. He now moves to vacate all the stipulations on the ground that NASD "manipulated" him into executing them. We have held previously that we will "honor stipulations in the absence of compelling circumstances" justifying setting the stipulations aside. Joseph Abbondante, Exchange Act Rel. No. 53066 (Jan. 6, 2006), 87 SEC Docket 203, 207 n.12 (citing James F. Glaza, d/b/a Falcon Fin. Serv., Inc., 57 S.E.C. 907, 914-15 n.7 (2004)), aff'd, 209 Fed. Appx. 6 (2006). The record does not support Pellegrino's assertion of manipulation. At a pre-hearing conference before Pellegrino agreed to the stipulations, the Hearing Officer told Pellegrino explicitly that he did not "have to stipulate to anything that [he] fe[lt] uncomfortable about." Although we thus deny the motion to vacate, we note that the assertions made in the stipulations are supported independently by other evidence in the record.

5/ NASD brought disciplinary proceedings against Sandifur, Swanson, and Olsen based on their alleged failures to supervise or maintain an effective supervisory system. All three settled without admitting or denying the allegations. Sandifur consented to a bar from association with any NASD member in any capacity, Swanson to a bar from association in a principal capacity and a $5,000 fine, and Olsen to a suspension from association in a principal capacity for one year and a $5,000 fine.

(continued...)

controlled both Metropolitan and Summit. Sandifur and Swanson worked on the sixteenth floor of the building Metropolitan and Summit shared with MIS; MIS was located on the second floor. Swanson, in addition to his position at MIS, also served as Metropolitan's corporate secretary and on its Board of Directors. 6/ Swanson saw no conflict of interest between his duties at MIS and Metropolitan "because [MIS was] selling a product Metro needed to continue its operations and the fact that the operation went very smoothly and so forth, was important to Metropolitan."

Olsen supervised MIS's 200 registered representatives. He had no experience in the securities industry prior to his employment with MIS, and MIS never provided him any formal training regarding his supervisory duties. Olsen testified that he "had great difficulty" and "great concerns" about supervising the registered representatives. The majority of the representatives were independent contractors located offsite in seven states. Olsen thought he was "exceeding [his] capability" and was concerned that he "had no staff" and that the representatives were "geographically dispersed." Olsen added that MIS's "first priority was generating sales."

According to their prospectuses, both Metropolitan and Summit "engaged in a nationwide business of acquiring, holding and selling receivables." These receivables included real estate contracts and promissory notes, structured settlements, annuities, lottery prizes, equipment leases, and other instruments. In its Form 10-K/A for the fiscal year ending September 30, 2000, Metropolitan described these receivables as "cash flowing assets." 7/ Metropolitan stated that it "predominantly invests in Receivables where the borrower or the collateral does not qualify for conventional financing or the seller or the buyer chose to use non-conventional financing." The Proprietary Products financed Metropolitan's and Summit's investments in receivables.

The Proprietary Products' debentures and investment certificates represented unsecured general obligations of Metropolitan and Summit. 8/ Metropolitan and Summit issued the debentures and investment certificates pursuant to indentures that did not restrict their ability to issue additional debentures or to incur other debt, including debt senior in right of payment to the

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5/ (...continued)
In a separate proceeding by the Commission alleging financial fraud at Metropolitan, Sandifur consented to a permanent injunction against violating the securities laws, disgorgement of $60,000 plus prejudgment interest, and a civil penalty of $75,000. SEC v. Sandifur, Litigation Release No. 20379 (Dec. 4, 2007), 92 SEC Docket 340.

6/ Olsen stated that Swanson spent only "a couple hours each day" at MIS.

7/ Summit also described the receivables as "cash flowing assets" in its Form 10-K for the fiscal year ending September 30, 2001, and stated that its goal was "to achieve a positive spread between the return on its Receivables and other investments and its cost of funds."

8/ See Black's Law Dictionary 330 (7th ed. 2000) (stating that a debenture is a debt secured only by the debtor's earning power, not by a lien on any specific asset).

debentures. In their prospectuses, both Metropolitan and Summit stated that their subsidiaries had no obligation to guarantee or otherwise pay amounts due under the debentures, and that the debentures were therefore effectively subordinated to all indebtedness and other liabilities and commitments of Metropolitan's and Summit's subsidiaries. No government entity guaranteed or insured the Proprietary Products.

2. Metropolitan's and Summit's Financial Condition

Although Metropolitan had been profitable for forty-eight consecutive years, in 1999 it began experiencing financial difficulty. For the next several years until it filed for bankruptcy in 2004, its earnings were insufficient to meet fixed charges and preferred stock dividends. On May 11, 2001, two months before Pellegrino joined MIS, Metropolitan issued a prospectus for debentures disclosing that its earnings were insufficient to meet fixed charges and preferred stock dividends by approximately $7.9 million for the three-month period ending December 31, 2000. The prospectus disclosed that earnings had been insufficient to meet fixed charges and preferred stock dividends by approximately $17.9 million for the fiscal year ending September 30, 2000 and $0.8 million for the fiscal year ending September 30, 1999. Metropolitan stated that investors might not receive the full amounts they were entitled to on their debentures if the earnings insufficiency continued. Metropolitan's balance sheet also reflected that it was highly leveraged. As of June 30, 2001, its debt-to-equity ratio was 35 to 1. Its cash inflows were also becoming increasingly dependent on sales of the Proprietary Products.

3. MIS's Sales Practices and Suitability Assessments

Many MIS customers checked boxes on their subscription agreements indicating a low risk tolerance. MIS staff testified that many customers "were unsophisticated," or "not comfortable or knowledgeable about perhaps diversification, asset allocation." Many of these customers were elderly retirees who had invested their savings with MIS and sought income. Pellegrino testified that he did not "think [MIS customers] knew or cared what they had because it paid them their money, and that's all they seemed to care about."

MIS's sales force recommended the Proprietary Products to customers as low-risk investments. For example, customers stated, in complaint letters sent to NASD, that MIS representatives assured them that their investments "were very safe," "were the safest and one of the best investments [they] could make," and "were a safe, extremely low-risk investment." Customers also wrote that their representatives stressed that "the company had never missed even one interest payment in the entire fifty years they've been in business" and that investing in the Proprietary Products "was much like placing money in a bank and collecting the interest" and "was as safe as putting money in the bank."

MIS's 2001 Supervisory Manual stated that "[i]f MIS recommends to a customer the purchase of its own securities or securities of an affiliate . . . MIS must have reasonable grounds to believe that the recommendation is suitable for the customer based upon the customer's investment objectives, financial situation and needs, and other information." MIS staff testified, however, that MIS did not base individual suitability determinations for its customers' Proprietary Product investments on the individual customer's financial situation and investment objectives. Instead, MIS based the suitability of an investment in the Proprietary Products on so-called "MIS Suitability Guidelines" (the "Suitability Guidelines"). The Suitability Guidelines provided that customers could invest in the Proprietary Products as long as an investment in the securities of Metropolitan and Summit combined did not exceed 40% of their net worth, an investment in the securities of either Metropolitan or Summit individually did not exceed 30% of their net worth, and an investment in the preferred stock of either Metropolitan or Summit did not exceed 20% of their net worth. The only other limitation on suitability contained in the Suitability Guidelines was that preferred stock could not be recommended to customers with "low risk tolerance portfolios." Olsen testified that, from his "very first day through every general manager," MIS's sole suitability criteria was that the investor must "meet concentration levels" and could invest in the Proprietary Products "as long as [the investor met] the concentration levels."

B. Pellegrino Joins MIS

Pellegrino joined MIS on July 5, 2001, as the firm's General Manager. As General Manager, MIS's September 2001 Supervisory Manual charged Pellegrino with "responsib[ility] for reviewing the firm's overall supervisory system." A chart of MIS's organizational structure depicted Pellegrino as MIS's highest-ranking officer. 9/

Pellegrino knew Metropolitan and Summit had financial problems when he considered MIS's offer of employment. He testified that when he "first took a look at the prospectuses" that Metropolitan sent him as part of the recruitment process, he thought, "What? Are you kidding. It was all red ink." James Dawson, NASD's district director at the time, told Pellegrino that MIS was "a risky business." Although Pellegrino "saw the losses," he nonetheless accepted the position.

Pellegrino's "[i]nitial impressions of MIS was a very disorganized, dysfunctional firm with some rogue reps, ineffective self-serving management prone to show favoritism, and running a business way too complex for the ability of the managers and staff." He testified that, when he started at the firm, his staff had no background in the securities industry and MIS had no understanding of a broker-dealer's duties to its customers. He realized, within two months of his arrival at MIS, that MIS's supervisory system "was deficient in that it needed improvement."

9/ Although indisputably MIS's president, Sandifur was not listed on this chart.

1. Pellegrino's Initial Compliance Efforts

Olsen testified that Pellegrino initially "embraced" Olsen's concerns regarding MIS's lack of supervisory staff and "too large numbers of reps [that were] geographically disbursed [sic]." Early on, Pellegrino took certain steps in response to those concerns. For example, Pellegrino hired two additional individuals as compliance staff. 10/ According to Swanson, Pellegrino also "cut down" the number of MIS registered representatives by eliminating representatives who were just "hanging their license" at MIS, who did not obtain a Series 7 license, or who had "background problems." 11/ MIS also eliminated representatives in the farthest locations because Pellegrino determined MIS could not supervise them properly. As part of this reduction, in August 2001, Pellegrino terminated the firm's relationship with a group of representatives operating under the name Great Northern Financial Services after MIS compliance staff expressed "serious concern" about their "methods for selling [and] the quality of their representatives."

Pellegrino also instituted a "7-7-0" standard for hiring new registered representatives. According to Pellegrino, in explaining the new standard, he "wanted someone who had a Series 7 license, preferably with some broad experience; 7 years of experience in the industry which would give [him] some comfort that they were well-versed, that they were at least a survivor beyond the first couple of years; and 0 meant 0 compliance or regulatory problems." Pellegrino stated that he "wanted new reps who were clean and diverse in their view and their background." This policy had minimal impact, however, because MIS was eliminating, not hiring, representatives during Pellegrino's tenure.

In addition, Pellegrino established what he referred to as the customer internal audit ("CIA") program. 12/ The CIA program involved sending a form to customers who purchased Proprietary Products asking whether they had received a prospectus and understood the risks and contacting customers when there were changes to a customer's financial information. The efficacy of the CIA program depended, therefore, on the willingness of MIS customers to respond as well as the content of their responses.

10/ Pellegrino testified, however, that neither of these new compliance staff members had prior compliance experience. One individual conducted branch audits, and the other ran Pellegrino's customer internal audit program. See infra.

11/ Although Pellegrino contends that he decreased the number of representatives to under ninety, the testimony at the hearing established that MIS had between 100 to 150 registered representatives during Pellegrino's tenure.

12/ Pellegrino stated that the CIA program "was at first random" and "got expanded to include everyone who bought preferred stock."

2. Pellegrino's Failure to Correct MIS's Deficient Supervisory System

Although Pellegrino took these steps to address certain problems at the firm, he did not address the significant deficiencies with MIS's overall supervisory system. For example, soon after joining the firm, Pellegrino recognized problems with Swanson's role as MIS's chief compliance officer. Pellegrino stated that Swanson "was a part-timer at best and a chief compliance officer in name only" and that Swanson's position with Metropolitan while serving as MIS's chief compliance officer represented a "conflict[] of interest." According to Pellegrino, he and Sandifur discussed replacing Swanson as chief compliance officer in August 2001 and February 2002. Pellegrino testified, however, that Sandifur "wouldn't let" him replace Swanson because Swanson had "been around forever."

In August 2002, the Washington State Department of Financial Institutions ("DFI") demanded that Pellegrino remove Swanson as chief compliance officer. The DFI became concerned about Swanson's performance after finding, during an examination, that he "had approved several types of [customer] correspondence containing problematic statements," and "recommend[ed] that Mr. Swanson no longer have responsibility for reviewing advertising or correspondence." Despite his earlier efforts to remove Swanson, Pellegrino asked the DFI "to reconsider its position." The DFI refused to allow Swanson to continue as chief compliance officer, citing a concern "that Mr. Swanson's duties as an officer of MIS and Metropolitan Mortgage may interfere with the best execution of any compliance duties assigned to him."

Although Pellegrino ultimately obeyed the DFI's directive and replaced Swanson with Olsen, he did not relieve Olsen of his existing responsibilities as supervisor of the registered representatives. Subsequently, Olsen told Pellegrino that he doubted his ability to handle both positions, 13/ but Pellegrino ignored his concerns.

3. Pellegrino Focuses on Sales and Disregards "Red Flags" of Compliance Problems

a. Metropolitan's and Summit's Financial Condition Continues Deteriorating

Pellegrino acknowledged that the financial statements of Metropolitan and Summit "concerned" him. Metropolitan's and Summit's financial condition continued deteriorating throughout Pellegrino's tenure. Metropolitan's earnings were insufficient to meet fixed charges and preferred stock dividends by about $40.2 million for the year ending September 30, 2001, $3.4 million for the year ending September 30, 2002, and $6.9 million for the three-month period ending December 31, 2002. Summit's earnings were insufficient to meet fixed charges and preferred stock dividends by about $7.6 million for the year ending September 30, 2001. The Proprietary Products' prospectuses contained this negative financial information. Pellegrino

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13/ Olsen sent Pellegrino an e-mail memorializing his concerns because he felt performing both functions was "perhaps more than a single person should do" and he "wanted it on the record that this [was] an issue with [him]."

testified that, at least as of March 2002, he considered preferred stock high risk and the debentures and investment certificates medium to high risk.

b. MIS Customers Do Not Understand the Risks of the Proprietary Products

In August 2001, NASD's Dawson warned Pellegrino that MIS's registered representatives were minimizing the risk associated with the Proprietary Products by comparing them to certificates of deposit and telling customers not to "bother looking at the prospectus." Pellegrino testified that his own discussions with customers left him unsure whether they "fully understood what they owned," and caused Pellegrino to doubt that they appreciated the associated risks.

In August 2002, Pellegrino retained Public Opinion Strategies ("POS"), a survey research company, to conduct focus groups with Metropolitan investors. In its report, POS concluded that MIS's customers did "not see [MIS] or its investment products as being high risk." Instead, POS found that investors viewed Metropolitan as "conservative" and "stable." POS noted that "debenture holders are not expert investors" and "place a significant amount of trust in their investment advisor." Pellegrino acknowledged at the hearing that POS's findings indicated that the average Metropolitan investor wanted a low-risk investment, believed Metropolitan to be conservative, and had a low level of awareness about the Proprietary Products. 14/

A subsequent survey of 150 MIS customers, in November 2002, confirmed that they underestimated the risks of the Proprietary Products. Although the survey found that "minimizing risk [was] the most important investment priority for Metropolitan customers," customers described Metropolitan as "financially strong," and a large majority believed that the debentures were "relatively risk free" -- over 75% of customers thought that their investment in Metropolitan or Summit was "more secure than conventional stocks and securities." At the hearing, Pellegrino acknowledged that the survey evidenced that the average Metropolitan investor generally believed Metropolitan was a conservative product, wanted a low-risk investment, and considered the Proprietary Products relatively risk free.

14/ Pellegrino testified that POS also conducted focus groups with individuals who did not invest in the Proprietary Products. Unlike the longtime MIS customers, Pellegrino stated that the non-MIS customers "reacted really strongly to the prospectus [for the Proprietary Products] and really strongly negatively to the prospectus." Rather than recognizing that these reactions indicated that existing customers failed to appreciate the increasingly risky nature of the Proprietary Products, Pellegrino stated that this reaction "gave [him] some comfort that the prospectus was an effective document."

Despite this obvious conflict between the actual riskiness of the Proprietary Products and customer perceptions of the level of riskiness, Pellegrino never asked Olsen to take further action in response to the POS findings. Pellegrino admitted that the POS findings did not prompt him to ask Olsen to look into whether MIS's registered representatives were misrepresenting the risks associated with the Proprietary Products. The record contains no evidence of other steps Pellegrino took to address the POS findings.

c. Pellegrino Focuses on Improving Sales

The evidence indicates that, rather than responding to the issuers' deteriorating financial condition and customers' flawed perceptions of the Proprietary Products' risks by implementing enhanced suitability procedures, Pellegrino focused on improving sales. He testified that he "inherited suitability guidelines that had been in place for years" and "had no reason to question the validity of those guidelines." According to Olsen, Pellegrino "became much more sales driven, sales oriented" as his tenure progressed and ultimately "viewed compliance, operational issues as more [of] an irritant to achieving the level of sales success that he was trying to achieve." Chris Sullivan, MIS's representative services coordinator, testified that, during his tenure at MIS, Pellegrino set a goal of $10 million in Proprietary Products raised per month and wanted 80% of funds in existing matured debentures reinvested in the Proprietary Products.

As part of his sales efforts, Pellegrino instituted contests to boost the registered representatives' efforts to push sales of Metropolitan and Summit preferred stock. Pellegrino also created a newsletter called "Hotline" that contained scripts to assist representatives in overcoming investor objections. Among other things, the scripts emphasized that the Proprietary Products lacked market volatility. Additionally, Pellegrino hired Bruce Bushman to be MIS's national sales manager in February 2002; Sullivan testified that Bushman "show[ed] individuals ways to come over [sic] objections for" the Proprietary Products.

Pellegrino also devised an abbreviated subscription agreement form (the "EZ Form") in order to ease the purchase of additional Proprietary Products by existing customers. The EZ Form allowed customers to reinvest in the Proprietary Products by affirming that their personal financial information had not changed since their prior investment and then selecting the term and rate at which they wanted to reinvest. Pellegrino acknowledged that the completed EZ Form did not refer to the customer's risk tolerance or investment objectives. Olsen testified that the EZ Form was "designed specifically to increase sales."

Pellegrino also created a report on customers' "buying power" (the "Buying Power Report") that determined for the representatives which of their clients could purchase more Proprietary Products and still stay within the Suitability Guidelines' concentration ratios. The Buying Power Reports "were sent to each representative so they would have a list . . . of their clients who essentially had room to invest more in the [P]roprietary [P]roducts." Olsen worried that the Buying Power Reports were "another step towards [sales of the Proprietary Products] being the primary priority rather than the needs of that investor."

Pellegrino's efforts to boost sales also entailed downplaying the issuers' financial performance. In an e-mail to Metropolitan's chief financial officer, Pellegrino wanted to "build our 'spin' for the FY Q2 loss in Metro." 15/ In another e-mail, Pellegrino noted that the "reps have to deal with a prospectus that is downright ugly in the amount and detail of risk disclosures," that it was "very difficult to overcome potential investor objections," and that MIS's "direction has been to focus the reps on the turnaround of the company."

The compliance meetings and training sessions that Pellegrino instituted also focused more on sales than compliance. Although MIS held what it called an "Annual Compliance Meeting" in September 2002, the meeting, which lasted two full days, devoted only two hours to compliance, and just ten minutes were spent discussing suitability. Olsen's compliance presentation at the meeting, moreover, reinforced MIS's focus on concentration of Proprietary Products holdings as the sole suitability determinant. Although a video of Olsen's presentation reveals that he directed the representatives to make "fair and balanced presentations," the only guidance he provided on suitability was when he described suitability as strictly a "mathematical equation," i.e., relying on the concentration levels. Olsen testified further that, even though he used the term "balanced presentation" at the meeting, other portions of the meeting might have given the representatives a mixed message. The record contains no evidence that Olsen provided appropriate guidance to the representatives, at this meeting or otherwise, regarding the kind of disclosures required to ensure that they made "balanced presentations."

Pellegrino also instituted monthly two-day training sessions for MIS's sales force, which Pellegrino called "Back to Basics." The "Back to Basics" sessions devoted only a small portion of time to compliance, with the primary emphasis being on sales. Sullivan testified that the first day focused on operations and technology and the second day focused on "sales training." The sessions did nothing to alter MIS's traditional approach to suitability determinations. For example, a slide presented at the sessions answered the question of "How much can my clients buy?" with respect to a particular Proprietary Product by summarizing the Suitability Guidelines' maximum concentration levels. Bushman, the national sales manager, ran the sessions, and Sullivan testified that Bushman focused "primarily on the sales of the [P]roprietary [P]roducts." He testified further that Bushman presented Metropolitan's financials in a positive light and did not make its losses "real upfront" to the representatives. He described the review of the issuers' financial performance as "here is the financials of the issuer and then here is their past track record of financials" and "here is how we can explain current financials." Another representative testified that Bushman "glossed over" the downside to the Proprietary Products. 16/

15/ Pellegrino testified that this e-mail reflected "a really bad choice of words."

16/ Pellegrino states in his brief that this representative's testimony "is disputed by other testimony" from the same registered representative, that this representative did not attend "required training and compliance meetings," and that this representative testified against

(continued...)

In meetings with MIS's registered representatives, Metropolitan executives similarly discussed Metropolitan's losses but highlighted its future prospects, stating that Metropolitan had "turned the corner." Although Pellegrino instituted quarterly conference calls for the representatives with Metropolitan officers in order to explain the issuer's financial situation, including its losses, the executives emphasized that the financials were "going to look really a lot better" in the future. Pellegrino admitted Metropolitan's tendency was to "downplay" liquidity concerns and that the discussion of the company's future "was biased in a positive fashion."

Pellegrino's sales efforts worked. The money MIS raised from sales of the Proprietary Products increased each year of Pellegrino's tenure; MIS raised $400 million from sales of the Proprietary Products in 2000, $500 million in 2001, and $700 million in 2002. Sullivan described Pellegrino as "[p]retty aggressive in terms of marketing," and Olsen described Pellegrino as "phenomenally successful" in generating sales.

C. NASD's Investigation, Pellegrino's Response, and the Firms' Collapse

On January 6, 2003, Pellegrino received a request for information from NASD and a notice that NASD would "soon begin an onsite examination of" MIS focusing on MIS's sales of Metropolitan's securities. Subsequently, Pellegrino took steps to address some of MIS's significant compliance failures that he had failed to address during the preceding year and a half. In its January 31, 2003 Compliance Manual, for example, MIS amended the Suitability Guidelines to bar investors desiring low risk from investing in the Proprietary Products.

Also on January 31, 2003, Pellegrino drafted and distributed to the representatives a memorandum entitled "Balanced Presentation and Discussion of Risk Factors." The memorandum stated that a "registered representative must first make sure that the investment is suitable based on the specific investment objectives and risk tolerance of the client" and that a "well-informed customer is in everyone's best interests." 17/ Sullivan described the memorandum's directive as "definitely a change" and something that Pellegrino emphasized "need[ed] to be done now." Olsen testified, however, that Pellegrino implemented this memorandum after, and in response to, NASD's investigation.

16/ (...continued)
Pellegrino because Pellegrino fired him. Pellegrino does not substantiate his assertions with evidence in the record, however, and no such evidence discredits this representative.

17/ The memorandum also stated that a "balanced presentation" was "one in which all factors relating to the potential risks and rewards of an investment are equally and completely disclosed to the prospect" and that a balanced presentation "would not favor the positive attributes of a proposed investment over the potential negative attributes."

In June 2003, shortly after Pellegrino gave testimony in NASD's investigation, Pellegrino finally relieved Olsen of his dual responsibilities for compliance and supervision of the firm's registered representatives. He hired Karen Arseneault as chief compliance officer because, according to Pellegrino, he "was concerned about [Olsen's] performance." Unlike Olsen, Arseneault had significant industry compliance experience, having worked previously at NASD as well as at other member firms. Pellegrino testified that "it would be an accurate statement to say that there would be no comparison in [his] mind between [Arseneault's] experience level and [Olsen's]." Arseneault's tenure at MIS began after the period at issue in this case.

On December 15, 2003, MIS ceased operations. Metropolitan and Summit issued press releases on December 26, 2003, advising investors that it had suspended dividends and payments of interest and principal on the Proprietary Products. In February 2004, Metropolitan, Summit, and MIS all filed for bankruptcy, and NASD cancelled MIS's registration in April 2005. Swanson testified that debenture holders might receive up to 30% of their investment back. He did not believe preferred stockholders would "get anything." 18/

NASD's investigation disclosed that, between October 2001 and March 2003, MIS registered representatives made at least 165 sales of the Proprietary Products totaling $4.1 million to customers who had invested more than 20% of their net worth in the Proprietary Products and who had indicated on their subscription agreements that they had a low risk tolerance or preservation of capital as their sole or primary investment objective. In twelve of these transactions, the representatives sold customers preferred stock despite the Suitability Guidelines' proscription on recommending preferred stock to low-risk investors. 19/

In 2003 and 2004, NASD received hundreds of customer complaints regarding MIS. As indicated, MIS customers complained that, among other things, the representatives who sold them the Proprietary Products presented the investments as "safe," "secure," and "conservative." 20/ Many of these customers had invested their life savings in MIS.

18/ The record does not otherwise address the extent of MIS customers' losses.

19/ Although NASD only focused on transactions of customers for whom it had subscription agreements, MIS's records show that many other customers with a low risk tolerance or preservation of capital as their sole or primary investment objective invested at least 20% of their net worth in the Proprietary Products, totaling roughly $17 million.

20/ One customer wrote that her representative "assured [her] that [Metropolitan] was doing well and would earn good interest for [her] investment dollars," another customer wrote that he "was only given positive information as to the risk factors involved," and another wrote that his representative said "that the risk for loss on the principal was non-existent." One customer stated explicitly that his representative "made no attempt to inform [him] of Metropolitan's worsening financial condition."

III.

A. NASD Rule 3010(a) requires that a member "establish and maintain" a supervisory system "that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with [NASD Rules]." 21/ In addition to an adequate supervisory system, "[t]he duty of supervision includes the responsibility to investigate 'red flags' that suggest that misconduct may be occurring and to act upon the results of such investigation." 22/ "Once indications of irregularity arise, supervisors must respond appropriately." 23/ "In large organizations it is especially imperative that those in authority exercise particular vigilance when indications of irregularity reach their attention." 24/ "Assuring proper supervision is a critical component of broker-dealer operations." 25/ "The standard of 'reasonable' supervision is determined based on the particular circumstances of each case." 26/ MIS's Supervisory Manual provided explicitly that Pellegrino was "responsible for reviewing the firm's overall supervisory system." 27/

21/ NASD Rule 3010(b) requires that a member "establish, maintain, and enforce written procedures" that are reasonably designed to achieve compliance with the securities laws. Although NASD's National Adjudicatory Council ("NAC") "reverse[d] the Hearing Panel's finding that Pellegrino implemented appropriate written supervisory procedures," it did not address whether MIS's procedures satisfied Rule 3010(b) or find that Pellegrino violated Rule 3010(b). Pellegrino's conduct with respect to that rule is thus not before us.

22/ Michael T. Studer, 57 S.E.C. 1011, 1023-24 (2004).

23/ La Jolla Capital Corp., 54 S.E.C. 275, 285 (1999).

24/ Wedbush Sec., Inc., 48 S.E.C. 963, 967 (1988).

25/ Richard F. Kresge, Exchange Act Rel. No. 55988 (June 29, 2007), 90 SEC Docket 3072, 3083.

26/ John A. Chepak, 54 S.E.C. 502, 513 n.27 (2000) (citing Christopher J. Benz, 52 S.E.C. 1280, 1284 (1997), petition denied, 168 F.3d 478 (3d Cir. 1988) (Table)).

27/ "A determination that a respondent has violated NASD's supervisory rule is not dependent on a finding of a violation by those subject to the respondent's supervision." Robert J. Prager, Exchange Act Rel. No. 51974 (July 6, 2005), 85 SEC Docket 3413, 3432-33 & n.52 (citing NASD Notice to Members 98-96 (Dec. 1998) (stating that a violation of Rule 3010 can occur in the absence of an underlying rule violation)).

Pellegrino notes that the DFI found, in an administrative proceeding against one MIS registered representative, Ross Bruner, that Bruner did not violate state law provisions prohibiting fraud, unsuitable recommendations, and dishonest and unethical sales

(continued...)

B. 1. Pellegrino did not exercise reasonable supervision in light of the circumstances under which he allowed MIS's registered representatives to recommend the Proprietary Products. Metropolitan and Summit reported substantial losses throughout Pellegrino's tenure, and Pellegrino's conversations with customers informed him that MIS's customers did not appreciate the risks associated with the Proprietary Products. The POS findings also indicated that the average Metropolitan investor had a low risk tolerance, believed Metropolitan was a conservative investment, and considered the Proprietary Products relatively risk free. Although Pellegrino himself considered the Proprietary Products medium to high risk investments, Olsen confirmed that Pellegrino never asked him to undertake an investigation in response to POS's findings, and no evidence exists of any other measures taken to address the overwhelming evidence that customers fundamentally misunderstood the riskiness of the Proprietary Products. This inaction constituted a failure to supervise reasonably because Pellegrino knew the registered representatives were recommending risky securities to investors who wanted, and thought they were getting, low-risk investments. 28/

Pellegrino defends the reasonableness of his supervision by claiming that some investors appreciated the risks. He notes that "the proprietary securities sold by MIS were . . . offered by prospectus only," that the "risk factors were clearly laid out in bold fonts in each prospectus," and

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27/ (...continued)
practices. He contends that the DFI's findings "show Rule 2110 and Rule 2310 conformity by this former rep as a result of MIS training during the relevant period." The DFI's opinions make no findings regarding NASD Rules 2310 and 2110 and no mention of the training Bruner received. One registered representative's compliance with NASD rules has no bearing on either NASD rule violations committed by other representatives or the reasonableness of supervision with a view to preventing rule violations. As noted above, the evidence indicates that MIS registered representatives made numerous unsuitable recommendations and misleading sales presentations to their customers.

28/ See Prager, 85 SEC Docket at 3432 (finding that "red flags and suggestions of irregularities" demanded "inquiry as well as adequate follow-up and review"); George J. Kolar, 55 S.E.C. 1009, 1016 (2002) (stating that "[d]ecisive action is necessary whenever supervisors are made aware of suspicious circumstances, particularly those that have an obvious potential for violations"); Quest Capital Strategies, Inc., 55 S.E.C. 362, 371 (2002) (stating that "supervisors must act decisively to detect and prevent violations of the securities laws when an indication of irregularity is brought to their attention"); James J. Pasztor, 54 S.E.C. 398, 412-13 (1999) (finding that supervisor "should have recognized from many red flags" that representative "was effecting wash trades and matched orders" and "[a]t a minimum . . . should have conducted an independent investigation to determine whether these trades, which [supervisor] recognized were a matter of concern, violated the federal securities laws"); Michael E. Tennenbaum, 47 S.E.C. 703, 711 (1982) (finding failure to supervise where, despite specific warnings of possible misconduct, supervisor "failed to take or recommend any action to investigate [the] activities").

that customers' awareness of these risk factors "was clearly acknowledged by the POS survey." The POS's findings revealed unequivocally that MIS investors generally did not understand the risks of the Proprietary Products. For example, the POS survey indicated that between 60% to 70% of investors believed the Proprietary Products were relatively risk free, and 75% of customers thought that their "Metropolitan/Summit Securities investment [was] more secure than conventional stocks and securities." In these circumstances, Pellegrino could not, as he did, ignore the POS findings simply because some customers appreciated the risks. Even if customers were receiving prospectuses, Pellegrino had solid information that investors desiring low risk were buying high-risk products. These facts called for an inquiry into and supervision of the sales efforts of the registered representatives.

Nor does the delivery of a prospectus demonstrate reasonable supervision over the representatives making the recommendations. Pellegrino's citation to the prospectus is especially misplaced because Dawson warned him that MIS registered representatives told customers not to "bother looking at the prospectus." Pellegrino himself sought to build "spin" for the losses and "focus[] the reps on the turnaround of the company" in light of a "downright ugly" prospectus.

Finally, the delivery of a prospectus and the disclosure of risks does not demonstrate that an MIS registered representative's recommendation to any particular customer was suitable or that the individual customer was able to take the risks involved with the Proprietary Products. 29/

Instead of correcting the misunderstanding of the overwhelming majority of customers, moreover, Pellegrino intensified the firm's sales efforts. As part of these efforts, he allowed individuals at Metropolitan and MIS to present the representatives with a positive assessment of the issuers' finances despite their deteriorating condition. Pellegrino's sales efforts exacerbated, rather than alleviated, the risk of unsuitable recommendations the POS findings revealed. 30/

29/ James B. Chase, 56 S.E.C. 149, 159 (2003) (finding that representative "did not satisfy the suitability requirement simply by informing [investor] of the risks of investing in [the speculative stock]" on the ground that "[m]ere disclosure of risks is not enough" because a "registered representative must 'be satisfied that the customer fully understands the risks involved and is . . . able . . . to take those risks'") (citation omitted); Larry Ira Klein, 52 S.E.C. 1030, 1036 (1993) (finding unethical sales practices despite representative's argument that he "delivered a prospectus to [investor] that disclosed the risks of investing" because representative's "delivery of a prospectus to [investor] does not excuse his failure to inform her fully of the risks of the investment package he proposed").

30/ Pellegrino notes that NASD issued a "Notice to Members" in 2004 discussing "sales practices obligations in the sale of bonds and bond funds." See NASD Notice to Members 04-30 (2004), available at www.finra.org. NASD issued the notice because it was "concerned that many investors may not fully appreciate the risks and costs associated with such products," and the notice cautioned firms who sold such products "to

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2. Pellegrino's failure to correct the registered representatives' exclusive reliance on the Suitability Guidelines when making a suitability determination constituted further unreasonable supervision. MIS staff testified consistently that MIS did not make individual suitability determinations for customers based on their financial situation and investment objectives. Instead, Pellegrino knew that MIS's Suitability Guidelines -- which based suitability exclusively on concentration levels -- were the sole suitability guidance the registered representatives received and effectively constituted MIS's sole suitability determinant. At MIS's annual compliance meeting in September 2002, for example, Olsen reiterated that suitability was strictly a "mathematical equation." 31/ Although concentration levels should be considered in assessing suitability, they cannot be the sole suitability determinant, particularly where, as here, the recommended securities carry substantial risks. The evidence indicates that, as a result of MIS's exclusive reliance on the Suitability Guidelines, the firm's representatives made numerous unsuitable recommendations during the time Pellegrino served as MIS's general manager by recommending substantial investments in the Proprietary Products to investors with a low risk

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30/ (...continued)
take appropriate steps to ensure that their registered representatives understand and inform their customers about the risks as well as the rewards of the products they offer and recommend." Id. Pellegrino contends, in reliance on the notice, that a finding "that the majority of MIS accounts did not appreciate the risk in the securities[] is consistent with that of debt purchasers at all member firms, and not specific to MIS." The extent of concerns among customers is not clear from the NASD notice, while at least 60% of MIS customers did not understand the risks of the Proprietary Products; however, even if Pellegrino's assertion was true, it does not establish reasonable supervision. "[W]e have repeatedly held that the fact that a practice is common or widespread in an industry does not make such conduct proper or legal." Ko Sec., Inc., 56 S.E.C. 1126, 1132 (2003) (citing cases), petition denied, 122 Fed. Appx. 364 (9th Cir. 2005) (Unpublished).

31/ Pellegrino cites Olsen's testimony that the meeting informed MIS's representatives that MIS expected balanced presentations. A ritualistic incantation of the words "fair and balanced," however, did not satisfy Pellegrino's duty to ensure that registered representatives made suitable recommendations, particularly where Olsen also described suitability as a "mathematical equation." Even assuming that the representatives were told to provide a balanced presentation, Pellegrino could not rely on the representatives' voluntary compliance with that directive; he had a duty to monitor and review the representatives' activities to verify that they made suitable recommendations. See Bradford John Titus, 52 S.E.C. 1154, 1160 (1996) (stating that the duty of supervision "includes monitoring compliance with a supervisor's instructions").

tolerance and conservative investment objectives. 32/ Pellegrino knew of the registered representatives' reliance on the Suitability Guidelines but failed to take corrective action.

Although the firm's written procedures instructed the representatives to make individual suitability determinations based on a customer's investment objectives, financial situation, and needs, "the presence of procedures alone is not enough. Without sufficient implementation, guidelines and strictures do not assure compliance." 33/ The evidence demonstrated that the representatives did not make individual suitability determinations for customers based on their financial situation and investment objectives and instead based suitability exclusively on the concentration levels in the Suitability Guidelines. Pellegrino did not ensure that the registered representatives complied with the suitability requirements. MIS did amend the Suitability Guidelines to prohibit selling the Proprietary Products to low-risk investors in January 2003, but reasonable supervision required that he act sooner, especially in light of red flags such as Metropolitan's and Summit's deteriorating financial condition and his increasing awareness that investors did not appreciate the Proprietary Products' risks. 34/

32/ See, e.g., Chase, 56 S.E.C. at 156-57 (finding that "high concentration of investments in one or a limited number of securities is not suitable for investors" seeking limited risk); Daniel Richard Howard, 55 S.E.C. 1096, 1099-1101 (2002) (finding "the speculative securities" recommended by applicant unsuitable for elderly investor "whose primary need was additional income and who sought investments that carried minimal risk"), aff'd, 77 Fed. Appx. 2 (1st Cir. 2003).

NASD found that MIS registered representatives made "at least 165 unsuitable recommendations, in violation of NASD Rules 2310 and 2110." NASD found further that the representatives "made misleading statements about the risks involved" in the Proprietary Products and that, in so doing, they "were at least negligent." Although we find that the evidence supports these findings of underlying violations by MIS registered representatives, we note that, as discussed above, we need not make such findings to support findings of supervisory failures by Pellegrino.

33/ Kresge, 90 SEC Docket at 3089 n.37 (quoting Rita H. Malm, 52 S.E.C. 64, 69 & n.17 (1994)); see also Gary E. Bryant, 51 S.E.C. 463, 470 (1993) (finding that a firm's procedures "must assure that restrictions issued are not ignored" and that a failure to establish such procedures "is symptomatic of a failure to supervise reasonably"); Frank J. Custable, Jr., 51 S.E.C. 855, 861 (1993) (finding a failure to supervise reasonably where applicants "failed to apply even their standard supervisory procedures").

34/ Pellegrino challenges the notion that the EZ Form "reinforced the position of MIS management that the concentration (ratio) standard was the primary suitability consideration in MIS." The EZ Form, however, did not refer to either the customer's risk

(continued...)

Pellegrino argues the "concentration ratios were not the sole basis for [a] suitability determination" but instead were "a measurement to additionally be used by the rep, and was mandated by the NASD and WA DFI." Although the concentration ratios may have originally been intended as an additional suitability measurement, they did not function this way during Pellegrino's tenure. Instead, as noted above, the evidence demonstrated that during Pellegrino's tenure MIS based suitability exclusively on the concentration ratios. Pellegrino cannot blame this process on NASD or DFI. Although the record indicates that NASD and DFI recommended that MIS not sell the Proprietary Products to investors who had exceeded a certain level of concentration in the Proprietary Products, no evidence suggests that either NASD or DFI approved concentration in the Proprietary Products as the sole measure of suitability, particularly in light of the increasingly dire financial situation of the issuers.

3. Pellegrino also acted unreasonably in addressing significant personnel problems at the firm. Rule 3010(a)(2) requires that members designate appropriately registered principals to carry out their supervisory responsibilities, 35/ and Rule 3010(a)(6) provides that, as part of their supervisory system, members shall make reasonable efforts to determine that all supervisory personnel are qualified through experience or training to execute their assigned responsibilities.

Although Pellegrino realized within two months at MIS that its supervisory system "was deficient in that it needed improvement," he waited to replace Swanson until a year into his tenure. Pellegrino acknowledged that Swanson "was a part-timer at best and a chief compliance officer in name only" and that Swanson's position as both an officer of Metropolitan and chief compliance officer of MIS presented a conflict of interest. Pellegrino acquiesced, however, when Sandifur wanted to retain Swanson as chief compliance officer because he had "been around forever." After the DFI initially recommended that Pellegrino replace Swanson, moreover, Pellegrino resisted. He did not remove Swanson until the DFI ordered the switch. Pellegrino contends that Sandifur prevented him from replacing Swanson, but Sandifur's recalcitrance does not explain Pellegrino's resistance to the DFI's recommendation that Swanson be removed. Nor does it absolve Pellegrino of responsibility for establishing an adequate supervisory system. 36/

34/ (...continued)
tolerance or investment objectives, and Pellegrino admitted in his testimony that it was not possible to discern this information from the form.

35/ Chepak, 54 S.E.C. at 506.

36/ See George Lockwood Freeland, 51 S.E.C. 389, 392 (1993) (finding that registered securities principal was required to insist on firm owner's cooperation and compliance with applicable requirements or resign and that until doing so he remained responsible for his duties); see also Pasztor, 54 S.E.C. at 409 n.28 (rejecting applicant's contention that he was "relieved of responsibility because he had to report to [firm's president who] could
(continued...)

The supervisory system remained weak after Pellegrino replaced Swanson with Olsen. Pellegrino designated Olsen as MIS's chief compliance officer without relieving him of responsibility for supervising approximately 100 registered representatives. Olsen himself expressed concern to Pellegrino about acting as both the chief compliance officer and representative supervisor. Olsen thought that performing both functions "was perhaps more than a single person should do." He admitted that he "had great difficulty and great concerns" about supervising the representatives even before he became chief compliance officer as well.

We have held repeatedly, furthermore, that it is "not sufficient for the person with overarching supervisory responsibilities to delegate supervisory responsibility to a subordinate, even a capable one, and then simply wash his hands of the matter until a problem is brought to his attention . . . . Implicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised." 37/ Pellegrino does not point to any steps he took to monitor Olsen's execution of his dual roles. Pellegrino acted unreasonably by overburdening Olsen and by failing to oversee Olsen's discharge of his duties. 38/ Although Pellegrino eventually replaced Olsen as chief compliance officer after becoming concerned with his performance, he did not hire Arseneault to be MIS's chief compliance officer until June 2003, after the period at issue in this case.

Pellegrino argues that "Olsen was capable and ready" to be MIS's chief compliance officer because he "attended NASD Annual Compliance Meetings," "had more staff assigned to compliance," "conversed regularly with other compliance professionals," "consulted with [NASD's] District office," "discussed suitability very clearly" at MIS's 2002 annual compliance meeting, and had "access to Ms. Arseneault" before she joined MIS officially. Whether or not Olsen's attendance at NASD compliance meetings, performance at MIS's 2002 compliance meeting, and conversations with Arseneault and other compliance professionals qualified him to be MIS's chief compliance officer, we believe it was unreasonable to require Olsen both to supervise the representatives and act as chief compliance officer at the same time. Olsen himself

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36/ (...continued)
overrule his decisions" because applicant had an obligation to monitor subordinate's performance and could not shift that responsibility to firm's president).

37/ Harry Gliksman, 54 S.E.C. 471, 484-85 (1999), aff'd, 24 Fed. Appx. 702 (9th Cir. 2001).

38/ Cf. Kresge, 90 SEC Docket at 3086, 3088 (finding that member's "supervisory system was not reasonably designed to achieve compliance with applicable federal securities laws and regulations and NASD rules" because, among other findings, supervisor had worked at the firm for only six months when he became responsible for a branch office and supervisor was already "'overwhelmed' with his other responsibilities").

questioned the reasonableness of this supervisory structure, and Pellegrino does not cite any steps he took in response to Olsen's concerns or to monitor Olsen's performance of both functions. 39/

C. Pellegrino contends that several supervisory actions -- such as instituting the "7-7-0" standard, adding compliance staff, and reducing the number of registered representatives -- demonstrate that he performed reasonable supervision. 40/ We must consider, however, whether his supervision "was reasonably designed to prevent the violations at issue, not weigh [his] supervisory performance in other areas against [his] deficiencies in the area under review." 41/ The 7-7-0 standard, for example, had minimal impact because MIS was eliminating, not hiring, registered representatives during this period. None of the steps Pellegrino took created a supervisory system reasonably designed to prevent the misconduct at issue here because they did not remedy the obvious potential for unsuitable recommendations and misleading sales presentations by MIS's existing sales force. Rather than altering the criteria for investing in the Proprietary Products in response to the issuers' declining financial condition, Pellegrino retained the concentration ratios in the Suitability Guidelines as the sole suitability determinant and focused on boosting sales. He failed to conduct any investigation in light of the POS findings revealing that customers did not appreciate the risks of the Proprietary Products. He also retained Swanson, a "part-time" chief compliance officer, until August 2002, and replaced Swanson with Olsen without relieving Olsen of his duties as representative supervisor. In these circumstances, the other supervisory steps Pellegrino executed do not render his supervision reasonable. 42/

39/ See Castle Sec. Corp., 53 S.E.C. 406, 413 (1998) (finding supervision unreasonable where applicant put an inexperienced individual in charge of compliance and supervision and did not monitor his performance or ensure that he understood the scope of his duties).

40/ Pellegrino cites other purported compliance measures that the record does not support. No evidence substantiates his assertions that "all customer complains were promptly and thoroughly investigated" and that "[t]here were reps put on heightened supervision." Olsen testified that the "weekly" compliance meetings Pellegrino cites "didn't go on for an extended period of time." Another measure Pellegrino cites, his initiation of "customer contact by phone or in person," actually constituted a red flag because Pellegrino stated in his investigative testimony that conversations with customers led him to believe that the customers did not appreciate the risks of the Proprietary Products.

41/ Quest Capital Strategies, 55 S.E.C. at 374.

42/ Cf. Albert Vincent O'Neal, 51 S.E.C. 1128, 1135 (1994) (stating that, under the Exchange Act, "the test is whether O'Neal's supervision was reasonably designed to prevent the violations at issue, not (as O'Neal would have it) whether, if all the many other supervisory functions he performed were taken into account, his overall supervisory performance somehow earned him a hypothetical passing grade"); see also George J. Kolar, 55 S.E.C. 1009, 1020 (2002) (rejecting supervisor's claim that he enacted

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Although Pellegrino does highlight some compliance measures that support his contention that MIS's procedures "would have improved in later years had the firm survived," these measures were insufficient to demonstrate reasonable supervision during his tenure. For example, the record substantiates Pellegrino's implementation of the "CIA" program. As discussed, however, although Pellegrino's implementation of the CIA program was a step in the right direction, its efficacy in identifying compliance problems was limited because of its dependence on the customers' own assessments of the risks involved. 43/ Moreover, Pellegrino did not amend the Suitability Guidelines to prohibit any investments in the Proprietary Products for low-risk investors, distribute a memorandum emphasizing the importance of a balanced presentation and a discussion of risk factors with customers, or hire a more competent compliance director allowing him to relieve the overburdened Olsen until 2003, after learning that the firm was subject to an NASD investigation. We recognize, as Pellegrino urges, that MIS had a deficient supervisory system before he joined the firm, but reasonable supervision required that Pellegrino correct the deficiencies promptly. 44/ Pellegrino's failure to take such steps until after NASD's investigation began demonstrates unreasonable supervision. 45/

Pellegrino faults NASD, the DFI, and a "barrage of new rules and regulation[s]" that required MIS's compliance for his supervisory failures. Although Pellegrino blames NASD for not informing MIS of its deficient practices and not taking earlier action against MIS, as well as the DFI for failing to inform MIS of a letter it wrote to the Commission in September 2002 alerting the Commission to Metropolitan's precarious financial condition, we have held repeatedly that "members and their associated persons 'cannot shift their burden of compliance to NASD.'" 46/ "A regulatory authority's failure to take early action neither operates as an estoppel

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42/ (...continued)
reasonable supervisory procedures because the "routine surveillance measures cited by [respondent] were clearly inapplicable to the situation that he confronted").

43/ See Quest, 55 S.E.C. at 373 ("As we have previously pointed out, '[s]upervisory personnel cannot rely solely upon complaints from customers to bring misconduct of employees to their attention, particularly where customers . . . may fail to realize that they have been mistreated.") (quoting Reynolds & Co., 39 S.E.C. 902, 917 (1960)).

44/ Cf. Tennenbaum, 47 S.E.C. at 711 (finding a failure to supervise where supervisor, rather than respond to "specific warnings that [representative] might be engaging in excessive trading," "engaged in 'foot-dragging'").

45/ Cf. Kresge, 90 SEC Docket at 3087 (finding a failure to supervise where supervisor's actions occurred "after NASD had begun its investigation").

46/ Id. (quoting B.R. Stickle & Co., 51 S.E.C. 1022, 1025 (1994)).

against later action nor cures a violation." 47/ Pellegrino was "not justified in relying on [NASD's or DFI's] silence." 48/ The record demonstrates, moreover, that NASD was not silent but warned Pellegrino of potential misconduct by MIS registered representatives. In any event, given the significant and obvious compliance deficiencies, Pellegrino must have been aware of them. As for MIS's need to comply with any "new rules and regulations," the evidence showed that Pellegrino chose not to investigate red flags of possible misconduct rather than being constrained from doing so by any lack of resources. We have held, moreover, that a "supervisor must act to ensure that each associated person is receiving appropriate supervision despite constraints on the supervisor's powers." 49/ Pellegrino was required to provide "effective staffing" and "sufficient resources" to ensure proper supervision. 50/

IV.

Pellegrino raises a number of procedural objections to this proceeding. He argues that the NASD's National Adjudicatory Council ("NAC") subcomittee reviewing the Hearing Panel's decision "was not prepared" at the oral argument. The transcript of the oral argument, however, refutes this assertion. The subcommittee members questioned Pellegrino about his testimony at the hearing as well as the brief he submitted to the NAC before the oral argument. 51/ We do not address whether a panel's preparation for an oral argument could justify a procedural objection.

47/ Stephen J. Horning, Exchange Act Rel. No. 56886 (Dec. 3, 2007), 92 SEC Docket 207, 221; see also Malm, 52 S.E.C. at 75 n.40 (rejecting applicant's contention that "because NASD noted no markup, pricing or other 'exceptions' during its audit . . . NASD was subsequently precluded from bringing markup or supervisory charges").

48/ See Apex Fin. Corp., 47 S.E.C. 265, 267 (1980) (finding that "applicants were not justified in relying on the agencies' silence" where applicant contended that he "asked for these agencies' comments on the offerings, none were forthcoming, and he therefore assumed that no regulatory provisions were being violated").

49/ Pasztor, 54 S.E.C. at 408 n.27 (citing Douglas Conrad Black, 51 S.E.C. 791, 795 (1993)).

50/ Stuart K. Patrick, 51 S.E.C. 419, 422 (1993) ("'Apart from adopting effective procedures broker-dealers must provide effective staffing, sufficient resources and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised.'") (quoting Mabon Nugent & Co., 50 S.E.C. 142, 143 (1989)), aff'd, 19 F.3d 66 (2d Cir. 1994)).

51/ Cf. Rafael Pinchas, 54 S.E.C. 331, 347 (1999) (rejecting applicant's contention that a "hearing panel member fell asleep during the hearing" because nothing in the record suggested "that the panel did anything other than give their full attention to the matter").

Pellegrino argues further that the "NAC, like the Hearing Panel, [gave] no standing to the best evidence in this entire matter, an actual video recording of the compliance meeting in October 2002." 52/ Although Pellegrino did not introduce this video at the hearing, the NAC admitted it into the record after Pellegrino's appeal of the hearing panel's decision, and it cited the video in its opinion. We have also considered the video as part of our de novo review of the proceeding, which cures any issue that might have existed below, 53/ and for the reasons stated above do not find that it alters our conclusions. 54/

Pellegrino also objects to the actions of counsel for NASD's Department of Enforcement. He contends that counsel brought the enforcement action in an "overzealous, career enhancing, and excessive" manner, called him "every vile name associated with being a scandalous offender," and gave a closing argument that "smear[ed]" Pellegrino "with an intentional purpose to discredit and place [him] into the category of the day's worse corporate criminals." The record establishes that Pellegrino received a fair hearing. Although counsel argued strenuously that Pellegrino failed to act appropriately at MIS, she did not smear Pellegrino, call him vile names, or compare him to corporate criminals. Counsel, moreover, did not make the findings Pellegrino appeals; the Hearing Panel and the NAC rendered the decisions sanctioning Pellegrino. Our de novo review further dissipates even the possibility of unfairness. 55/

Pellegrino complains further that NASD opposed the introduction of Dawson's testimony at the hearing, and he "challenge[s] [NASD]" to "contact[] the former District Director regarding conversations between he and [Pellegrino] and then provide a sworn affidavit to the" Commission. Before the hearing, Pellegrino sought an order pursuant to NASD Rule 9252 requiring NASD to make Dawson, an NASD employee, available for testimony. According to Pellegrino, Dawson would testify that he thought Pellegrino did a good job at MIS.

52/ The record indicates that the compliance meeting actually took place in September 2002.

53/ See Robert Bruce Orkin, 51 S.E.C. 336, 344 (1993) ("Furthermore, our de novo review of this matter cures whatever bias or disregard of precedent or evidence, if any, that may have existed below."), aff'd, 31 F.3d 1056 (11th Cir. 1994).

54/ See supra text following note 15 and accompanying note 31.

55/ See Robert Tretiak, 56 S.E.C. 209, 232 (2003) (rejecting applicant's contention "that counsel for the NASD made false and inflammatory remarks and displayed bias and prejudice" where counsel "acted within the bounds of appropriate advocacy" and, in any event, "the hearing panels and the NAC, not counsel, made the final decisions in both disciplinary matters, and our de novo review dissipates even the possibility of unfairness"); Stephen Russell Boadt, 51 S.E.C. 683, 685 (1993) (rejecting applicant's contention that "the instant sanction is the result of a vendetta against him by the Regional Counsel" because "even if we were to find that Regional Counsel were biased, that would not suggest that the fairness of the hearing itself was compromised").

Rule 9252 provides that a request that NASD compel testimony will only be granted if, among other things, the information sought is relevant, material, and non-cumulative. The Hearing Officer denied Pellegrino's motion on the ground that the testimony Pellegrino sought was not relevant and material. The Hearing Officer held that whether Dawson "stated that Respondent was doing a good job after the relevant period is not material or relevant to the allegations of this proceeding" because "the Hearing Panel is charged with determining whether Respondent discharged his supervisory duties adequately" and the "Hearing Panel will not base its decision on the beliefs of Mr. Dawson." The Hearing Officer also noted that Pellegrino could testify as to his conversations with Dawson, which Pellegrino did. 56/ We do not believe Dawson's non-appearance at the hearing prejudiced Pellegrino or denied him due process. 57/

Pellegrino also notes that "[i]t has been nearly five years that [he has] been stuck in the FINRA/NASD enforcement process" and that he does not "believe any independent, rational view of this timeline could be called fair or timely." Pellegrino establishes no prejudice from the

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56/ Although Pellegrino contends that he has "been rebuffed at every attempt to bring" into the record his efforts "to establish a dialogue and relationship with the NASD and the District Director," he does not deny that he had the opportunity to, and did, testify about these conversations. Pellegrino stated that he talked with Dawson as part of "an ongoing effort to communicate, to update, [and] to ask questions" and that Dawson "acknowledged that [Pellegrino] had stepped out and always had been open and asked for direction and for help on anything that was of issue to the district office." This testimony is undisputed, and we accept it here.

57/ Cf. Guang Lu, Exchange Act Rel. No. 51047 (Jan. 14, 2005), 84 SEC Docket 2639, 2650-51 (rejecting due process challenge to NASD's denial of applicant's motion to compel the production of certain documents, including documents in a proceeding by the Maryland Securities Division against applicant, because the "Maryland Securities Division case was not material to NASD's proceeding against [applicant]" as "NASD had the independent burden of proving its allegations against [applicant]"), petition denied, 179 Fed. Appx. 702 (D.C. Cir. 2006); A.S. Goldman & Co., 55 S.E.C. 147, 168-69 (2001) (rejecting due process challenge to NASD's denial of applicants' motion to compel the testimony of twelve other market makers in a security whom applicants contended would testify that applicant firm did not dominate the market in the security because the "testimony of other market makers as to their perception of the marketplace or the bona fides of their quotes is not probative of the issue of [the applicant firm's] domination and control of the market for" the security); U.S. Sec. Clearing Corp., 52 S.E.C. 92, 100-01 (1994) (rejecting due process challenge to NASD's refusal to allow applicants "to call two NASD employees as witnesses or admit an affidavit regarding a meeting Applicants had with these two individuals" where applicants asserted that the NASD employees "wanted to put [applicant] out of business" on the ground that "this testimony is irrelevant to the issues of" the applicants' violations because "these violations are amply supported by the record" and applicant "was permitted to testify at the hearing about these conversations").

length of the proceeding. 58/ We do not believe, moreover, that the approximately five-year period during which NASD conducted an investigation, filed a complaint, held a hearing, issued a decision, and entertained an appeal was unreasonable in light of the voluminous record. 59/

VI.

Under Section 19(e)(2) of the Securities Exchange Act of 1934, we may reduce or set aside sanctions imposed by NASD if we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition. 60/ NASD's Sanction Guidelines for a failure to supervise recommend a fine between $5,000 and $50,000 and, in egregious cases, a suspension of up to two years or a bar in any or all capacities. 61/ In this case, NASD deemed Pellegrino's supervisory failures egregious and barred him from serving in a principal capacity. 62/

Several aggravating factors suggest that the bar in a principal capacity is not excessive or oppressive. The Sanction Guidelines provide that a principal consideration in determining the appropriate sanction is whether the respondent ignored "red flags" that should have resulted in additional supervisory scrutiny. As noted above, Pellegrino ignored several red flags.

Another principal consideration affecting the sanction for a failure to supervise is the nature, extent, size, and character of the underlying misconduct. Pellegrino's supervisory failures resulted in MIS's registered representatives making numerous unsuitable recommendations and misleading customers as to the risks of the Proprietary Products over an extended period. Moreover, Pellegrino did not simply enable this underlying misconduct by supervising unreasonably; he facilitated this misconduct by promoting sales of the Proprietary Products to MIS customers rather than improving compliance. As a result, MIS customers incurred significant losses. At the hearing, it was estimated that debenture holders would receive only 30% of their investment back, and that preferred stockholders would lose their entire investment.

58/ Cf. Mark H. Love, 57 S.E.C. 315, 323 (2004) (evaluating whether length of delay in filing NASD complaint prejudiced applicant and finding no prejudice where applicant's ability to present a defense was not harmed by the passage of time since the alleged misconduct).

59/ Cf. C. James Padgett, 52 S.E.C. 1257, 1278 (1997) (rejecting contention that proceeding was not resolved within a reasonable time where proceeding was contested vigorously by the parties and the record was "immense"), aff'd, 159 F.3d 637 (D.C. Cir. 1998) (Table).

60/ 15 U.S.C. § 78s(e)(2). Pellegrino does not claim, and the record does not show, that NASD's action imposed an undue burden on competition.

61/ NASD Sanction Guidelines 108.

62/ NASD did not impose monetary sanctions in light of Pellegrino's personal bankruptcy.

Most of MIS's customers were elderly retirees. The nature, extent, size, and character of the underlying misconduct aggravates Pellegrino's violations. 63/

The third principal consideration in the sanction guideline for failing to supervise is the quality and degree of the supervisor's implementation of the firm's supervisory procedures and controls. As noted above, Pellegrino failed to enforce MIS's written supervisory procedures with respect to suitability determinations. The evidence established that Pellegrino failed to take reasonable steps to monitor and have MIS perform appropriate individual suitability determinations based on each investor's personal financial needs as prescribed in MIS's supervisory and compliance manuals; MIS based suitability solely on the Suitability Guidelines.

As further support for its sanction, NASD noted that Pellegrino did not take responsibility for his misconduct. Pellegrino states that he "cannot and will not admit responsibility for something that is untrue." The record, however, supports findings that Pellegrino committed supervisory violations. Pellegrino's refusal to recognize his misconduct "reveal[s] a fundamental misunderstanding of his supervisory duties." 64/ The principal bar "will protect investors from dealing with securities professionals who are not adequately supervised." 65/

Although Pellegrino does not address the appropriate sanction in his briefs explicitly, he asserts that he "was at the wrong place at the wrong time." The circumstances that existed at MIS before Pellegrino's arrival cannot mitigate Pellegrino's supervisory failures because Pellegrino recognized the problems MIS faced yet did not make a sufficient effort to try to correct those deficiencies. Instead, Pellegrino allowed MIS's supervisory system to remain inadequate during his more than two-year tenure as MIS's General Manager. A supervisor is "required to fulfill the obligations attached to his office for as long as he occupie[s] the

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63/ In his reply brief, Pellegrino states that he "continue[s] to try and help those customers who suffered financial losses from the collapse of the issuers." He attaches to this brief a letter regarding his cooperation in a class action lawsuit by injured investors. The letter notes that Pellegrino has provided cooperation to the plaintiffs "[p]ursuant to the terms of a Settlement Agreement." We do not believe Pellegrino's cooperation pursuant to a settlement agreement justifies reducing the sanctions here. Cf. Thomas J. Donovan, Exchange Act Rel. No. 52883 (Dec. 5, 2005), 86 SEC Docket 2652, 2662 ("In any event, we do not consider Donovan's after-the-fact efforts to help Knight recover some of its losses to have much relevance to our determination of the public interest.").

64/ Horning, 92 SEC Docket at 226.

65/ Id.

position." 66/ Pellegrino did not fulfill his obligations. 67/ In this situation, we cannot find that the environment Pellegrino entered when he joined MIS warrants lesser sanctions. 68/

In addition, Pellegrino argued emphatically in his closing argument that he "did the best job [he] could to the best of [his] ability." We agree that Pellegrino made compliance efforts. He added compliance staff, reduced the number of MIS registered representatives, and instituted the 7-7-0 standard for hiring new representatives. These efforts do not mitigate Pellegrino's misconduct significantly, however, because they did not redress the risk of unsuitable recommendations stemming from the representatives' exclusive reliance on the Suitability Guidelines as a measure of suitability. The measures that Pellegrino took in response to NASD's investigation, furthermore, such as the distribution of the "Balanced Presentation and Discussion of Risk Factors" memorandum and the proscription on selling the Proprietary Products to low-risk investors, occurred too late to constitute substantial mitigation, especially as they were prompted by the investigation. Other compliance measures, such as the CIA review, do not justify lesser sanctions in light of their obvious inadequacy in the face of red flags. Instead of responding to these red flags, Pellegrino instituted measures that promoted sales of the Proprietary Products, thereby exacerbating the risk of unsuitable recommendations by representatives who were relying exclusively on the Suitability Guidelines in making those sales. Pellegrino's efforts do not mitigate his failure to act in the face of patent irregularities. 69/

66/ See Kirk A. Knapp, 50 S.E.C. 858, 864 (1992) (finding firm president "required to fulfill the obligations attached to his office for as long as he occupied the position").

67/ We do not find mitigating Pellegrino's testimony that he considered resigning but worried about finding other employment in the job market following September 11, 2001.

68/ Pellegrino notes that Sandifur settled a Commission enforcement action and was barred from serving as an officer or director of a public company for five years and fined $150,000. We have held repeatedly, however, that "the appropriate sanction depends upon the facts and circumstances of each particular case and cannot be determined precisely by comparison with actions taken in other proceedings or against other individuals in the same proceeding." Benz, 52 S.E.C. at 1285 (citing Butz v. Glover Livestock Comm'n Co., 411 U.S. 182, 187 (1973); Hiller v. SEC, 429 F.2d 856, 585-59 (2d Cir. 1970)). "This is especially true with regard to settled cases, where, as we have frequently pointed out, pragmatic factors may result in lesser sanctions." Anthony A. Adonnino, 56 S.E.C. 1273, 1295 (2003), aff'd, 111 Fed. Appx. 46 (2d Cir. 2004).

69/ Michael H. Hume, 52 S.E.C. 243, 248-49 (1995) (finding sanctions not excessive or oppressive despite supervisor's argument that "he did the best job he could" because supervisor failed to act in the face of "irregularities that he himself detected").

In barring Pellegrino in a principal capacity, NASD noted that it was "tailoring [its] sanctions to address Pellegrino's egregious supervisory failures." 70/ In declining to bar Pellegrino in all capacities, NASD determined that an additional sanction would have limited remedial value because Pellegrino's misconduct occurred "in his capacity as a supervisor, not as a general securities representative." 71/ The principal bar serves to "'secure compliance with the rules, regulations, and policies of'" NASD "without imposing sanctions unnecessary to remedy the misconduct." 72/ NASD appropriately tailored the sanction of a principal bar to remedy and deter Pellegrino's misconduct, and the sanction is not excessive or oppressive. 73/

An appropriate order will issue. 74/

By the Commission (Chairman COX and Commissioners CASEY, AGUILAR, and PARADES); Commissioner WALTER not participating.

Florence E. Harmon
Acting Secretary

70/ The Hearing Panel had imposed a six-month suspension in all capacities. The NAC modified this sanction to the bar in a principal capacity. As discussed below, we believe the principal bar is more appropriately tailored to address Pellegrino's misconduct.

71/ NASD also noted, as do we, that terminating the firm's association with the Great Northern representatives was mitigating.

72/ Sisung Sec. Corp., Exchange Act Rel. No. 56741 (Nov. 5, 2007), 91 SEC Docket 3050, 3064 (quoting Boruski v. SEC, 289 F.2d 738, 740 (2d Cir. 1961)).

73/ See General Sec. Corp. v. SEC, 583 F.2d 1108, 1109-10 (9th Cir. 1978) (finding Commission decision affirming bar in a principal capacity imposed by NASD "sound and rational" where Commission noted that the sanctions NASD imposed "afforded some leniency in that 'no fine was assessed and the sanction imposed on [applicant] was appropriately tailored to fit his failings as a manager and supervisor'").

74/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 59125 / December 19, 2008

Admin. Proc. File No. 3-12941

In the Matter of the Application of

RONALD PELLEGRINO
825 Sudden Valley
Bellingham, WA 98229

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NASD against Ronald Pellegrino be, and it hereby is, sustained.

By the Commission.

Florence E. Harmon
Acting Secretary