

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 52580 / October 11, 2005

Admin. Proc. File No. 3-11847

In the Matter of the Application of  
  
CASTLE SECURITIES CORP.  
45 Church Street  
Freeport, New York 11520  
  
For Review of Disciplinary Action Taken by  
  
NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY  
PROCEEDINGS

Violations of NASD Rules

Failure to Transmit Order Reports

Inadequate Supervisory Procedures

Failure to Accept or Decline Trades

Former member firm of registered securities association failed to submit required reports to the association's Order Audit Trail System ("OATS"), failed to establish and maintain proper supervisory procedures to ensure OATS compliance, and failed to accept or decline trades as required by the association's Automated Confirmation Transaction Service. Held, association's findings of violation are sustained, and the sanctions imposed are sustained in part.

## APPEARANCES:

Michael T. Studer, president, for Castle Securities Corp.

Marc Menchel, Alan Lawhead, and Carla J. Carloni, for NASD

Appeal filed: March 7, 2005

Last brief received: June 6, 2005

## I.

Castle Securities Corp. ("Castle" or "the Firm"), a former NASD member, appeals from NASD disciplinary action. NASD found that Castle violated (1) NASD Marketplace Rule 6955(a) and Conduct Rule 2110 by failing to submit required information to NASD's Order Audit Trail System ("OATS") 1/; (2) Conduct Rules 3010 and 2110 by failing to establish and maintain proper supervisory procedures to ensure OATS compliance 2/; and (3) Marketplace Rule 6130(b) and Conduct Rule 2110 by failing to comply with the requirements of NASD's Automated Confirmation Transaction Service ("ACT"). 3/

NASD fined Castle \$25,000 for its OATS violations; fined the Firm \$40,000 and suspended it for 30 business days or until implementation of NASD-approved supervisory procedures for its supervisory violation; and fined the Firm \$15,000 for its ACT violations. 4/ We base our findings on an independent review of the record.

## II.

In 1996, after finding certain "potentially serious" violative activities in the Nasdaq stock market, we directed NASD to, among other things, "design and implement . . . an audit trail sufficient to enable the NASD to reconstruct markets promptly, effectively surveil them and

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- 1/ Marketplace Rule 6955(a) requires the transmission of applicable order information to OATS. Conduct Rule 2110 mandates adherence to high standards of commercial honor and just and equitable principles of trade.
- 2/ Conduct Rule 3010 requires the establishment and maintenance of a supervisory system and written procedures reasonably designed to achieve compliance with applicable regulations.
- 3/ Marketplace Rule 6130(b) requires the contra party to a transaction involving Nasdaq securities to accept or decline a trade within twenty minutes after execution. NASD has renamed ACT, in combination with other NASD systems, the "Nasdaq Market Center."
- 4/ NASD also assessed costs.

enforce its rules." <sup>5/</sup> NASD accordingly developed OATS. In approving the rules that NASD adopted to implement that system, we stated, "A comprehensive audit trail, beginning with the time an order is placed and continuing to record the life of the order through the process of execution, is essential to maintaining the integrity of the Nasdaq market." <sup>6/</sup>

NASD's implementation of OATS occurred in three stages. As pertinent here, the second stage required that member firms report to OATS all electronic orders for Nasdaq securities. Castle registered for OATS' second phase on July 6, 1999. NASD then notified the Firm (via NASD's OATS Internet Website) that its scheduled date to begin OATS reporting was September 15, 1999.

Castle has stipulated that, during the period September 15, 1999 through June 16, 2000, it received, originated or transmitted electronic orders in Nasdaq securities. However, during that period, which encompassed 191 consecutive business days, it failed to submit any order information to OATS. On June 7, 2000, NASD wrote to Castle requesting information regarding the Firm's apparent failure to transmit required information. Castle submitted the missing OATS data on June 19. On June 21, Michael Studer, Castle's president, replied to NASD's June 7 letter. Studer stated that all required data through June 20 had now been submitted. He also asserted that Castle had a verbal agreement with Galaxynet, Inc., an affiliate of Castle Holding Corp. ("CHC"), Castle's parent corporation, "to assist in the transmission of OATS data." Beginning June 19, Castle began reporting to OATS but, four months later, during the period October 19 through December 7, 2000 (a total of 35 business days), Castle's OATS transmissions were rejected because the Firm had allowed its OATS password to expire. <sup>7/</sup> On or about December 8, NASD advised Studer that the Firm had not reported any data to OATS since October 18. Castle then resumed its OATS transmissions.

Marketplace Rule 6955 specifies that, unless such information is unavailable, each order report must be transmitted to OATS "on the day such event occurred." It is clear that, during the two periods noted above, Castle did not transmit required order information to OATS.

Castle claims that it outsourced its OATS reporting responsibilities to Galaxynet. The record contains no evidence of an agreement between the two firms. In any event, Rule 6955(c) provides that, while a member may contract with an agent to fulfill the member's reporting obligations, the agreement must be evidenced in writing. The rule further provides that, notwithstanding the existence of an agreement, the reporting member remains primarily responsible for compliance with the requirements of Rule 6955. Castle also seeks to fault NASD

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<sup>5/</sup> National Association of Securities Dealers, Inc., 52 S.E.C. 875, 880.

<sup>6/</sup> Securities Exchange Act Rel. No. 39729 (March 6, 1998), 66 SEC Docket 2078, 2080.

<sup>7/</sup> As with the earlier period, Castle stipulated that, during the October-December period, it received, originated, or transmitted electronic orders in Nasdaq securities.

for not notifying it sooner of its failures to transmit information. However, Castle cannot shift its responsibility for compliance to NASD. 8/

In light of the foregoing, we sustain NASD's findings of OATS violations by Castle. 9/

### III.

NASD Rule 3010 requires NASD members to establish and maintain written procedures, reasonably designed to achieve compliance with applicable regulations, to supervise the types of business in which members engage. During the relevant period, Castle's written procedures with respect to OATS failed to meet that standard. In 1998, NASD issued a Notice to Members dealing with supervisory responsibility for trade reporting. The Notice listed four specifications to be included in a firm's written supervisory procedures: (1) identification of the individual responsible for supervision; (2) the supervisory steps and reviews to be undertaken by that individual; (3) the frequency of such reviews; and (4) the manner in which the reviews are to be documented. 10/

The Firm's supervisory procedures identified Studer as "OATS Supervisor with overall responsibility for OATS reporting." 11/ However, with the exception of clock synchronization, they contained no information with respect to the manner, method, frequency, or documentation of any review that Studer might conduct. The procedures also failed to identify a person or process responsible for reviewing the accuracy and timeliness of trade reporting conducted by third parties on the Firm's behalf.

At the hearing before NASD's National Adjudicatory Council ("NAC"), Studer stated with respect to OATS, "I wish I was more on top of it and I wasn't. I admit it." 12/ He further

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8/ See, e.g., Michael F. Flannigan, Exchange Act Rel. No. 47142 (January 8, 2003), 79 SEC Docket 1132, 1143.

9/ NASD Rule 6956 specifically provides that a failure to comply with Rule 6955 "may be considered conduct that is inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110."

10/ NASD Notice to Members 98-96 (December 1998), 1998 NASD LEXIS 121 at \*8.

11/ The procedures specified that the OATS supervisor or his designee was responsible "for maintaining and changing the OATS password every 60 days."

12/ Studer also stated that the Firm had previously hired an attorney "to help with the supervisory procedures." Castle now points to that fact. However, that circumstance did not obviate the Firm's responsibility to ensure that its procedures were adequate. Cf. Rita H. Malm, 52 S.E.C. 64, 73 (1994). Particularly in light of the guidance that NASD had provided to its members, the Firm and Studer should have known that the Firm's

stated that, when he was informed that the Firm's procedures were deficient, the deficiencies were corrected "as soon as they were pointed out." We note, however, that, on April 23, 2001, nearly five months after the Firm's OATS violations, an attorney for Castle, responding to a letter from NASD's OATS Compliance Section outlining the deficiencies in Castle's procedures, stated that it was Castle's position that its current supervisory procedures were satisfactory. The letter went on to state, however, that, in order "to dispel any possible ambiguity, the firm had amended its procedures." The amendment provided that Studer would conduct an OATS review "at least quarterly," and "evidence [that] review by initialing and dating the records that [were] required to be maintained by [the Firm's OATS] procedures."

Castle's written supervisory procedures lacked necessary provisions detailing the supervisory oversight to be accorded the Firm's OATS transmissions by the designated "overall" supervisor. Thus they proved inadequate and ineffective to prevent or detect the Firm's OATS violations. We accordingly sustain NASD's findings of violation.

#### IV.

ACT is an automated system (owned and operated by The Nasdaq Stock Market) that compares Nasdaq trade information entered by ACT participants and submits "locked-in" trades to the National Securities Clearing Corporation for clearance and settlement. <sup>13/</sup> As pertinent here, the party with reporting responsibility must enter its version of a trade into the ACT system. The contra party then reviews the trade and accepts or declines it. An acceptance results in a locked-in trade; a declined trade report is purged from the ACT system. <sup>14/</sup>

Marketplace Rule 6130(b) specifies the times within which each party to a Nasdaq trade must act. The party with reporting responsibility must transmit a trade report to the system within 90 seconds after execution. The contra party must utilize ACT's "Browse" function <sup>15/</sup> to accept or decline the trade within twenty minutes after execution. Between October 1 and December 31, 2001, Castle, the contra party, failed to accept or decline 1,399 trades in ACT within the requisite twenty minutes.

Castle asserts that substantially all of its late ACT reports involved transactions routed electronically to NDB Capital Markets by Castle Online customers. NDB was a "contracted

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procedures were deficient.

<sup>13/</sup> See Exchange Act Rel. No. 27229 (September 8, 1989), 44 SEC Docket 961, 962. As noted above, NASD has renamed ACT the "Nasdaq Market Center," and amended its rules accordingly.

<sup>14/</sup> NASD Rule 6140(b).

<sup>15/</sup> NASD Rule 6110(e) defines "Browse" as the ACT function that permits a participant to review trades that identify the participant as a party to the transaction.

broker" to which Castle's customers could route their unsolicited orders. According to Castle, NDB had agreed to handle Castle's ACT reporting for most of the transactions at issue. The record refutes that claim. In a March 14, 2002 letter to NASD, an attorney for Castle admitted that NDB had refused to provide ACT services for Castle. At the NAC hearing, Studer stated, "Originally our agreement was that [NDB] would make ACT reports for us, . . . and that didn't happen. . . . We were forced to use human beings and unfortunately we were beyond 20 minutes. I admit it."

We accordingly sustain NASD's findings of ACT violations by Castle. 16/

## V.

A. Castle argues that, contrary to NASD's conclusion, its violations were not egregious. It asserts, among other things, that any late reporting to OATS and ACT was not intentional, did not cause any economic harm to customers, and was promptly corrected when brought to Castle's attention. It further states that NASD's Sanction Guidelines call for substantially lower fines than NASD assessed, and that NASD ignored the Guidelines' admonition that a firm's small size must be considered in imposing sanctions. Castle also argues that NASD overstated the seriousness of its disciplinary record, and that NASD has settled cases involving similar charges against larger firms for lesser sanctions.

OATS is an important regulatory tool that substantially enhances NASD's ability to conduct surveillance of its member firms. Castle failed to comply with the requirements of OATS during two distinct and lengthy periods, and corrected its failures only when NASD brought them to its attention. Moreover, instead of accepting responsibility for its violations, Castle sought to shift the blame to Galaxynet and also to NASD for not apprising it sooner that OATS was not receiving required transmissions. 17/

In determining the appropriate sanctions for Castle's supervisory failures, NASD stressed

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16/ NASD Rule 6180 provides that the failure of an ACT participant to comply with ACT "may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110."

17/ Castle asserts that, in September 1999, there were over 200 broker-dealers who failed to report order information to OATS. We have repeatedly pointed out that it is no defense that others in the industry may have been operating in an improper manner, and we do not consider that circumstance a mitigative factor here. See Charles E. Kautz, 52 S.E.C. 730, 733 (1996), and the authorities there cited. Castle also points out that the OATS Sanction Guidelines call for a fine of \$1,000 to \$2,000 for a "first action." However, the OATS guidelines specify a fine of \$10,000 to \$150,000 for "egregious cases." We agree with NASD's finding that Castle's OATS violations were egregious in light of the Firm's repeated failures to comply with reporting requirements during two lengthy periods of time.

the fact that, as noted below, Castle has previously been disciplined twice for failure to exercise proper supervision. 18/ Here, the Firm's supervisory deficiencies once again led to violative conduct. Moreover, after learning of its initial non-compliance with OATS reporting, the Firm did nothing to rectify its supervisory deficiencies, leading to a second period of OATS violations.

As noted, Castle committed 1,399 ACT violations. As an NASD examiner testified, compliance with the provisions of ACT "is necessary for the efficiency of the Nasdaq marketplace in regard to [the] clearing and processing [of] trades." NASD properly determined to treat Castle's multiple violations as an aggravating factor in assessing the sanction for this offense. 19/ We further note that, once again, instead of accepting responsibility for its violations, Castle sought to shift the blame elsewhere, this time to NDB.

In addition to the sanctions suggested for particular offenses, NASD's individual Sanction Guidelines reference the Guidelines' "Principal Considerations," which are applicable to all sanction determinations. One of those considerations is a respondent's disciplinary record. The Guidelines suggest the imposition of "progressively escalating sanctions on recidivists." In assessing sanctions in this matter, NASD properly took into account Castle's dismal regulatory history.

In 1998, we sustained NASD findings that Castle manipulated the market for a security, and charged customers excessive and fraudulent markups. We also affirmed NASD's finding that Castle failed to establish, implement, and enforce reasonable supervisory procedures designed to prevent such misconduct, a failure that allowed the manipulation and markup violations to occur. 20/

In 2003, the United States District Court for the Southern District of New York found that Castle had engaged in a fraudulent blind pool offering and a market manipulation. The Court enjoined Castle from further violations of registration and antifraud provisions of the securities laws, noting that Castle's violations were "egregious and repeated," that Castle had not acknowledged any wrongdoing or accepted any responsibility for the frauds perpetrated on the public, and that there was a reasonable likelihood that, unless enjoined, Castle would continue to engage in conduct violative of the securities laws. 21/

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18/ See nn. 20 and 22, *infra*, and the related text. NASD's Sanction Guidelines for deficient supervision provide for a fine of \$5,000 to \$50,000.

19/ NASD's Sanction Guidelines provide that "numerous similar violations may warrant higher sanctions, since the existence of multiple violations may be treated as an aggravating factor."

20/ *Castle Securities Corporation*, 53 S.E.C. 406.

21/ *SEC v. U.S. Environmental, Inc., et al.*, 2003 U.S. Dist. LEXIS 12580, Fed. Sec. L. Rep.

In 2004, we sustained NASD findings that Castle churned a customer's account, failed to exercise proper supervision over the trading in that account, and improperly induced the customer, an elderly, infirm woman, to guarantee the margin accounts of five unrelated Castle customers. 22/ We noted in our opinion that Castle has been the subject of regulatory proceedings by this Commission and NASD on no less than eight different occasions since 1989, and has twice been the subject of regulatory proceedings brought by state securities commissions. 23/

In light of the foregoing, we cannot agree that NASD overstated the seriousness of Castle's disciplinary history. As NASD noted, Castle "repeatedly has faltered in its supervisory responsibilities, . . . has demonstrated disregard for regulatory requirements, [and] has posed a danger to the investing public."

Castle's disciplinary history is a significant aggravating factor and an important consideration in weighing the sanctions imposed in this matter. In light of the Firm's misconduct at issue in this proceeding and its extensive disciplinary record, we are unable to conclude that the fines assessed by NASD are excessive or oppressive. Nor do we consider that they impose an undue burden on competition. 24/ However, in light of the facts that Castle has previously withdrawn its broker-dealer registration (effective December 30, 2003) and been expelled from NASD membership, 25/ we consider the suspension imposed by NASD inappropriate and

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(CCH) ¶ 92, 471, aff'd, 114 Fed. Appx. 426 (2d Cir., Oct. 29, 2004). We brought administrative proceedings against Castle and Studer based on the injunction. However, since Castle had withdrawn its broker-dealer registration, we determined to dismiss the proceedings as to Castle. Michael T. Studer, Exchange Act Rel. No. 50411 (September 20, 2004), 83 SEC Docket 2853, 2854 n.1, aff'd, No. 04-5901, 2005 U.S. App. LEXIS 19556 (2d Cir., Sept. 9, 2005) (unpublished opinion).

22/ Michael T. Studer, Exchange Act Rel. No. 50543A (November 30, 2004), 84 SEC Docket 911.

23/ Id., 84 SEC Docket at 924-925.

24/ Castle points out that the NASD Guidelines state that adjudicators should consider firm size "with a view toward ensuring that the sanctions imposed are not punitive." NASD considered Castle's size, noting that, under its Guidelines, entities that control a firm are to be taken into account. Here, NASD pointed out that Castle is a wholly-owned subsidiary of CHC, and is just one of several CHC subsidiaries. Like NASD, we do not consider that Castle's size warrants any reduction in the sanctions imposed. As for Castle's complaint with respect to the assessment of lower sanctions in settled cases, we have repeatedly pointed out that pragmatic considerations justify the acceptance of lesser sanctions in negotiating a settlement. See, e.g., Steven D. Goodman, 54 S.E.C. 1203, 1212 (2001).

excessive. We shall therefore set it aside.

B. Castle argues that NASD ignored the Sanction Guidelines' admonition requiring adjudicators to consider a respondent's bona fide inability to pay when imposing a fine. In fact, NASD considered Castle's claim and rejected it.

It is well settled that a respondent bears the burden of demonstrating an inability to pay, and that NASD is entitled to make a searching inquiry into any such claim. 26/ Castle has not met that burden. The most recent financial information in the record is a draft FOCUS report submitted to NASD by Castle after the hearing before NASD's Hearing Panel. As the NAC noted, the report shows that, as of June 2003, Castle had total assets of \$69,707, total liabilities of \$32,899, and excess net capital of \$12,046. An April 30, 2003 balance sheet submitted by Castle shows total assets of \$59,442, total current liabilities of \$23,906.97, and \$21,094.39 net capital. In its post-hearing submission to the Hearing Panel, Castle stated that its parent corporation, CHC, had made capital contributions of \$102,000 to Castle for the nine months ended June 30, 2003.

According to Castle, both its own financial situation and that of CHC have substantially deteriorated since June 2003. However, Castle has not documented that change. 27/ We conclude that Castle has failed to demonstrate an inability to pay the fines that NASD assessed in this matter.

An appropriate order will issue. 28/

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25/ See Michael T. Studer, *supra*, n.22.

26/ E. Magnus Oppenheim & Co., Inc., Exchange Act Rel. No. 51479 (April 6, 2005), 85 SEC Docket 475, 484.

27/ Castle points to a "Rule 17a-11 Notice," dated July 23, 2003, indicating a negative net capital position for Castle. The "Notice" is in the form of a letter to NASD from Studer acknowledging that NASD had advised the Firm that it had just incurred a substantial liability in the injunctive action referred to above that must be recorded immediately. In the letter, Studer states that, if the liability must be recorded, the Firm's net capital will be deficient. He asserts, however, that the Firm has not yet received the court's decision or "researched the necessary accounting for this event," and accordingly, that Castle "does not know at this time whether it agrees with the NASD or not." We note that NASD's Sanction Guidelines provide that "monetary sanctions imposed on member firms need not be related to or limited by the firm's required minimum net capital."

28/ We have considered all of the arguments advanced by the parties. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

By the Commission. (CHAIRMAN COX and Commissioners GLASSMAN, ATKINS, and NAZARETH); Commissioner CAMPOS not participating.

Jonathan G. Katz  
Secretary

UNITED STATES OF AMERICA  
before the  
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934  
Rel. No. 52580 / October 11, 2005

Admin. Proc. File No. 3-11847

In the Matter of the Application of  
  
CASTLE SECURITIES CORP.  
45 Church Street  
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For Review of Disciplinary Action Taken by  
  
NASD

ORDER MODIFYING DISCIPLINARY ACTION TAKEN BY REGISTERED SECURITIES  
ASSOCIATION

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

ORDERED that the fines assessed by NASD against Castle Securities Corp., and  
NASD's assessment of costs, be, and they hereby are, sustained, and it is further

ORDERED that the suspension imposed on Castle by NASD be, and it hereby is, set  
aside.

By the Commission.

Jonathan G. Katz  
Secretary