

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. E1020040299-01

TO: Department of Enforcement
NASD

RE: First Hudson Financial Group, Inc., Respondent
BD No. 32926

Pursuant to Rule 9216 of NASD Code of Procedure, First Hudson Financial Group, Inc. ("First Hudson" or "Respondent") submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described in Part II below. This AWC is submitted on the condition that, if accepted, NASD will not bring any future actions against Respondent alleging violations based on the same factual findings.

First Hudson understands that:

1. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by NASD's Department of Enforcement and National Adjudicatory Council Review Subcommittee ("NAC") or Office of Disciplinary Affairs ("ODA"), pursuant to NASD Rule 9216;
2. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against the firm; and
3. If accepted:
 - a. this AWC will become part of Respondent's permanent disciplinary records and may be considered in any future actions brought by NASD or any other regulator against it;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Respondent's disciplinary record;
 - c. NASD may make a public announcement concerning this agreement and the subject matter thereof in accordance with NASD Rule 8310 and IM-8310-2; and
 - d. Respondent may not take any action or make or permit to be made

any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any allegation in this AWC or create the impression that the AWC is without factual basis. Nothing in this provision affects First Hudson's testimonial obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

First Hudson also understands that the firm's experience in the securities industry and disciplinary history may be factors that will be considered in deciding whether to accept this AWC. That experience and history are as follows:

First Hudson has been a member of NASD since August 28, 2002. The firm's main office is located at 55 Broadway in New York, New York. The firm conducts a general securities business. On July 11, 2003, the New York Stock Exchange issued a decision that censured First Hudson and fined it \$30,000 for, among other things, violating New York Stock Exchange Rule 342 for failing to provide appropriate supervisory control with respect to its floor brokerage activities. First Hudson does not have any other formal disciplinary actions within the last five years.

I.

WAIVER OF PROCEDURAL RIGHTS

First Hudson specifically and voluntarily waives the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against it;
- B. To be notified of the Formal Complaint and have the opportunity to answer the allegations in writing;
- C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and
- D. To appeal any such decision to the NAC and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, First Hudson specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

First Hudson further specifically and voluntarily waives any right to claim that a person violated the ex parte prohibitions of Rule 9143 or the separation of functions prohibitions of Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

II.

ACCEPTANCE AND CONSENT

- A. First Hudson hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of NASD, or to which NASD is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by NASD:

Fair Commissions

NASD Conduct Rule 2440 and IM-2440 prohibit member firms from charging customers more than fair commissions in over-the-counter transactions, taking into account relevant circumstances, including market conditions regarding the security, expenses of executing the order, and the value of any service rendered. Additionally, IM-2440 provides a guideline that commissions should generally not exceed 5% and that a pattern of commissions of 5% or less may be considered unfair or unreasonable.

While Rule 2440 and IM-2440 are directly applicable to over-the-counter transactions, they also offer guidance to member firms generally regarding fair pricing of commissions.¹ "Implicit in the concept of fair pricing of commissions is the notion that commissions must not be so excessive as to make it unlikely that the customer's investment could appreciate sufficiently to compensate the customer for commissions and generate a profit."²

Excessive Commissions on Certain Option Transactions

During the period January 6 through April 5, 2004 (the "relevant period"), First Hudson, acting through PF, a general securities representative and

¹ See *Atlanta-One, Inc.*, Exchange Act Release No. 35455, 1995 SEC LEXIS 593, at **8-9, 52 S.E.C. 161, 164-165 (1995), *aff'd*, 100 F.3d 105, 1996 U.S. App. LEXIS 19817 (9th Cir. 1996) (involving foreign currency options); *Department of Enforcement v. Berry-Shino Securities, Inc.*, NASD Disciplinary Proceeding No. C3A030001, *slip. op.* at 8 and 13-14 (Hearing Panel) (December 10, 2003)(involving listed foreign currency options) at http://www.nasd.com/web/groups/enforcement/documents/oho_disciplinary_decisions/nasdw_006498.pdf.

² *Atlanta-One, Inc.*, 1995 SEC LEXIS 593, at *8, 52 S.E.C. at 164.

general securities principal, charged unreasonable and excessive option commissions on eight of 169 covered calls, ranging from 5.3% to 54%.³ The eight transactions were conducted on an agency basis and related to three over-the-counter securities — Vaxgen (VXGN), Netease (NTES) and Keryx (KERX).

The firm routinely charged its customers commissions of less than five percent for each of the following types of transactions: a) the purchase of underlying equity securities, b) the purchase of covering options to close pre-existing option positions, and c) the sale of the underlying equity securities. In contrast, in certain instances, as set forth in Attachment A, the firm charged customers far greater commissions (as high as 54%) for the sale of covered calls. In assessing the appropriateness of the commissions on the sale of the covered calls, the firm combined the commissions charged on the purchase and sale of the underlying equities, and the opening sale and subsequent closing purchase of covering options.

The firm erred in treating the equity and options transactions as one transaction for purposes of calculating and assessing the appropriateness of the commissions charged, particularly where the transactions were not part of a simultaneous buy-write strategy.⁴

Moreover, the firm failed to have an adequate supervisory system in place to prevent and detect excessive commissions on option transactions.

The eight instances of excessive option commissions were as follows:

- The firm charged commissions ranging from 10.9% to 54% on four covered-call transactions on securities that had been purchased through the firm between seven to fifteen days earlier.
- The firm charged commissions of 33.3% and 35.3%, respectively, on two covered call transactions on securities that the firm's customers had transferred to the firm from other brokerage firms.
- The firm charged combined commissions of 5.3% and 10.3%, respectively, on two sets of buy-write transactions where the firm purchased the underlying securities, and, on the same day, wrote

³ "Covered call writing" occurs where a call option is sold against an underlying equity securities position, giving the option holder the right to buy the underlying shares at the option strike price (a predetermined exercise price), prior to its expiration.

⁴ A true buy-write transaction involves the purchase of stock and the simultaneous writing of call options against stock position.

covered calls on the securities.

Neither market conditions, the rendering of special services, nor expenses of executing the options, nor any other factor, justified the level of the commissions in question.

By reason of the foregoing, First Hudson violated NASD Conduct Rule 2110.

Supervision

During the relevant period, First Hudson failed to implement a supervisory system and procedures reasonably designed to ensure that commissions charged in connection with option transactions were fair, reasonable and not excessive. The firm lacked written procedures on the subject. Moreover, the firm did not use any objective guideposts or exception reports to flag possible excessive option commissions.

By reason of the foregoing, First Hudson violated NASD Conduct Rules 2860(20)(A), 3010 and 2110.

Conclusion

By reason of the foregoing, First Hudson violated NASD Conduct Rules 2860(20)(A), 3010 and 2110.

- B. First Hudson also consents to the imposition, at a maximum, of the following sanctions:
1. A censure;
 2. A fine of \$15,000; and
 3. First Hudson shall make payment of restitution to the customers set forth in Attachment A, in the total amount of \$7,792.75 (representing that portion of commissions calculated by NASD staff to be in excess of 5%), plus interest at the rate set forth in Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. 6621(a)(2), from February 13, 2004, the last date of the violative conduct until the date this AWC is accepted by the NAC. Satisfactory proof of payment of the restitution or of reasonable and documented efforts undertaken to effect restitution shall be provided to NASD staff no later than 120 days after acceptance of this AWC. If for any reason First Hudson cannot locate any customer identified in Attachment A after reasonable and

documented efforts within such period, or such additional period agreed to by the staff, First Hudson shall forward any undistributed restitution and interest to the appropriate escheat, unclaimed property, or abandoned property fund for the state in which the customer is last known to have resided.

4. First Hudson shall undertake to perform the following:
 - (a) within twenty-five days of the effective date of this AWC, retain an independent consultant not unacceptable to the Department of Enforcement to review and make written recommendations for First Hudson's implementation of a supervisory system and procedures reasonably designed to ensure that commissions charged in connection with option transactions are fair, reasonable and not excessive and that such commissions are adequately disclosed to customers.
 - (b) upon retention of the consultant, report this retention to the Department of Enforcement.
 - (c) require the consultant to make written recommendations to First Hudson not later than twenty-five days after the consultant's retention.
 - (d) upon receipt of the consultant's written recommendations, provide a copy to the Department of Enforcement.
 - (e) not later than twenty-five days from the issuance of the consultant's report, implement the consultant's recommendations and provide to the Department of Enforcement satisfactory proof of implementation.

The sanctions imposed herein shall be effective on a date set by NASD staff.

III.

OTHER MATTERS

- A. First Hudson understands that it may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. The firm understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD or its staff.

- B. First Hudson agrees to pay any monetary sanctions imposed on them upon notice that this AWC has been accepted and that such payments are due and payable and have attached Election of Payment forms showing the method by which the firm proposes to pay any fine imposed.
- C. First Hudson specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

First Hudson certifies that it has read and understands all of the provisions of this AWC and has been given a full opportunity to ask questions about it, and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein, has been made to induce them to submit it.

First Hudson Financial Group, Inc.,
Respondent

12/9/05
Date

By: [Signature]
Yuet K. Wong, President

Reviewed by:

[Signature]
Gusrae, Kaplan, Bruno
& Nusbaum, PLLC
Counsel for Respondent
120 Wall Street
New York, NY 10005
(917) 520-2836
Bill Singer, Partner

Accepted by NASD:

January 17, 2006
Date

Signed on behalf of the Director of
ODA, by delegated authority

[Signature]
Gary A. Chodosh
Regional Counsel
NASD Department of Enforcement
One Liberty Plaza
New York, New York 10006
(212) 858-4771

NASD District Director

Hans Reich

NASD, District 10

One Liberty Plaza

New York, New York 10006

(212) 858-4180

ATTACHMENT A

Customer Initials	Restitution Amount
ACF	\$2,545.00
BS	\$1,483.75
DF	\$2,739.00
RZ	\$1,025.00
Total	\$ 7,792.75

Transactions Upon Which Restitution is Based

Customer Initials									
1	BS	2/9/2004	Vaxgen Feb @ 5	Sell	9 Call	\$5.10	4,590.00	\$1,590.00	\$1,365.00
2	BS	2/11/2004	Netease Feb @ 35	Sell	5 Call	\$7.90	3,950.00	\$1,990.00	\$118.75
3	DF	2/12/2004	Vaxgen Feb @ 5	Sell	5 Call	\$5.40	2,700.00	\$1,350.00	\$1,225.00
4	DF	2/12/2004	Keryx Feb @ 7 1/2	Sell	5 Call	\$3.90	1,950.00	\$975.00	\$787.50
5	DF	2/13/2004	Keryx Jun @ 12 1/2	Sell	5 Call	\$2.75	1,375.00	\$712.50	\$164.00
6	DF	2/13/2004	Keryx Feb @ 7 1/2	Sell	5 Call	\$3.50	1,750.00	\$750.00	\$562.50
7	RZ	2/11/2004	Netease Feb @ 35	Sell	5 Call	\$7.80	3,900.00	\$1,900.00	\$1,025.00
8	ACF	2/9/2004	Vaxgen Feb @ 5	Sell	18 Call	\$5.20	9,360.00	\$2,995.00	\$2,545.00

STATEMENT OF CORRECTIVE ACTION

This Corrective Action Statement is submitted by the Respondent. It does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD, or its staff.

- Mr. Michael Simon (CRD No. 2873408), the firm's FINOP, was appointed as SROP and ROP in October 2004, and will continue to act in such capacities unless another SROP other than the President of the firm acts in such capacity or firm discontinues its option business. Mr. Simon started his career in the securities industry as deputy attorney general in the NJ Division of Criminal Justice (Securities Division). Thereafter, he worked for the American Stock Exchange as an enforcement attorney investigating brokers, and member firms. During his tenure at the AMEX, Mr. Simon frequently handled matters involving options transactions, which have historically been a significant aspect of the exchange's business. Mr. Simon left the AMEX to start his own law practice, which specialized in securities regulation and arbitration. Furthermore during this time, Mr. Simon served as an adjunct professor at the John Jay College of Criminal Justice. After six years of private practice, Mr. Simon joined Sharpe Capital, Inc. as the General Counsel and branch compliance manager for the firm's Boca Raton, Florida office. As the branch compliance officer, Mr. Simon reviewed broker transactions (including options); and analyzed monthly statements, turnover ratios and profit and loss. Mr. Simon reviewed new account forms and option agreements to ensure that the forms were properly completed and the necessary disclosure documents were sent to the customers and appropriately dated on the forms. Thereafter, Mr. Simon joined National Securities Corporation, where he served as the firm's regulatory counsel advising the firm on sales practices, and securities rules and regulations. Mr. Simon is presently the Chief Financial Officer at First Hudson Financial Group.
- The firm will utilize a commission policy of charging specific dollar per contract. The firm believes this policy is more appropriate in that it will avoid the combination commission strategy which was utilized by Mr. Fatta. It will also avoid the appearance of overcharging on options and undercharging on other transactions. With this program the firm believes the commission rates will be more clear cut and succinct and avoid having to figure out which underlying equities trade was part of the global transactions in which a large commission (which appears excessive) was charged. It will also ensure that the 5% guidelines not be breached as the commission will only relate to each transaction on its own. In essence each transaction will have a commission tied to it to avoid confusion to its customer. Furthermore, the firm has and will continue to prohibit Mr. Fatta's approach.
- The firm has maintained an independent consultant, KAPCO Group Inc. KAPCO Group has been working with the firm over a year providing its expertise and education to continually improve the firm's options policies and procedures.