

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. EAF0400370004

TO: Department of Enforcement
NASD

RE: Glen S. Davis, CRD No. 1070334

Pursuant to Rule 9216 of the NASD Code of Procedure, Glen Davis 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 Davis alleging violations based on the same factual findings.

Davis 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 ("NAC"), Review Subcommittee 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 Davis; and
3. If accepted:
 - a. this AWC will become part of Davis' permanent disciplinary record and may be considered in any future actions brought by NASD or any other regulator against Davis;
 - b. this AWC will be made available through NASD's public disclosure program in response to public inquiries about Davis' 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. Davis 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 the Respondent's testimonial

obligations or right to take legal or factual positions in litigation or other legal proceedings in which NASD is not a party.

Davis also understands that his experience in the 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:

Davis first entered the securities industry in October of 1982 as a general securities representative and worked as a retail broker with Paulson Investment Company, Inc. ("Paulson") a Portland, Oregon-based company that maintains more than 100 retail registered representatives ("brokers"). Davis then took the position of sales manager and was registered as a general securities principal. Approximately five years ago, Davis, while maintaining his responsibilities as sales manager, became President of Paulson, a position he no longer holds. In addition, he was registered as a municipal fund securities principal in 2003. Davis has no prior disciplinary history.

I.

WAIVER OF PROCEDURAL RIGHTS

Davis 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 him;
- 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, Davis 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.

Davis 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

Davis 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 fact or law, to the entry of the following findings by NASD:

SUMMARY

In the summer of 2003, three brokers from Paulson's branch office in Park Avenue, New York, asked Davis, then the President of Paulson, for new broker codes in order to gain more market-timing capacity for their market-timing clients and evade efforts by mutual fund companies to detect and prevent market timing. At first, Davis denied the request for new broker codes and told the brokers that he would not approve new broker codes unless they provided him with a legitimate business reason for the codes.

In response, the brokers told Davis that they wanted new broker codes so they could segregate and track their trades to increase operational efficiency. Davis approved the creation and use of four new joint broker codes for Paulson brokers in the Park Avenue branch engaged in market timing. The brokers then used these broker codes to make approximately 48 mutual fund trades for their market-timing clients and earned those clients approximately \$64,000 in profits. After approving the joint broker codes, Davis did not monitor the brokers' activity to ensure that the brokers did not use the codes for illicit market timing. As a result, Davis violated NASD Conduct Rules 3010 and 2110.

BACKGROUND OF MARKET TIMING

Unlike securities listed on an exchange, the net asset value ("NAV") of most U.S.-based mutual funds currently is calculated only once per day at 4:00 p.m. Eastern Time, based upon the prices of individual securities taken at the closing time of their respective local time zones. This method of mutual fund valuation provides market timers the opportunity to engage in arbitrage based on market information not reflected in that day's NAV. In order to execute this strategy, market timers typically buy and sell shares in mutual funds on a short-term basis, realizing quick gains and then retreating to the previous market position. Market timing is not illegal *per se*. It can harm long-term mutual fund shareholders, however, because it can dilute the value of their shares, by, among other things, large and frequent redemptions forcing managers to set aside cash that would otherwise be invested in securities to obtain the fund's stated objectives or by increasing the transaction costs for the fund. Long-term fund investors may ultimately bear the burden of paying these costs. In addition, trading profits obtained by market timers can result in losses to long-term mutual fund shareholders.

Many mutual fund companies monitor trading activity for market timing and attempt to enforce restrictions and limitations on market timing through written and oral communications, or notices, blocking or rejecting trades. The notices vary from reminders as to the fund company's market timing policies and procedures, to warnings that an account is permitted one more transaction, to absolute restrictions from effecting additional transactions in the securities of that fund company ("block notices").

At times, market timers employ a number of strategies to attempt to avoid detection and continue market timing after a mutual fund has attempted to prevent future trading activity. These strategies may include opening and trading in multiple related accounts and using different names, tax ID numbers, broker code numbers, and addresses. Market timers undertake these efforts in an attempt to gain more market-timing capacity, or increased access to market-timing opportunities in any given fund company.

PAULSON'S BROKERS ENGAGED IN MARKET TIMING

In January 2003, a newly-hired broker in Paulson's Park Avenue, New York branch office opened the firm's first market-timing account for an institutional client. In the ensuing nine months, Paulson's market-timing business grew until five brokers, including four brokers in Paulson's Park Avenue branch, had eleven hedge-fund clients with forty-four market-timing accounts and approximately \$67 million in assets in the firm. These forty-four accounts were opened for the express purpose of market timing. Through September 2003, the clients market timed over 50 fund families and executed more than 3,000 trades through their accounts at Paulson.

In February 2003, Paulson received its first communication from a mutual fund rejecting a trade for market timing. In March 2003, Davis, then the

President of Paulson, received an e-mail from Paulson's clearing firm, which informed him that several mutual funds viewed the timing activities of Paulson's brokers as improper and unwelcome.

**PAULSON'S BROKERS TOLD DAVIS THEY WANT NEW BROKER CODES
TO HIDE FROM MUTUAL FUNDS THAT MONITORED FOR MARKET
TIMERS**

Initially, Davis was not familiar with market timing. As Paulson's brokers increased their market timing, Davis asked them to speak to their clients to get a better understanding of how market timing worked and how market timers were able to generate profits through their trading. Consequently, the brokers spoke to their clients and took notes, which were faxed to Davis on May 15, 2003.

The clients used these conversations to identify ways to expand the market-timing business through a variety of means, most of which were designed to hide the true identity of the client. Taken together, the brokers' notes of their conversations and the fax represented the clients' road map for deception and evasion. The clients' proposals included: 1) establishing offshore accounts; 2) negotiating market-timing capacity with the funds; 3) new branch numbers; 4) new broker numbers; 5) new account numbers; 6) use of different entities to market time; and 7) hiding the broker's name. One of the brokers wrote that the client "was not pleased with the amount of cancelled trades. The reason for this is capacity is shrinking with the rep numbers we have. Once again, changing and or getting multiple rep numbers is key to our survival."

The brokers feared that the mutual fund companies, which were rejecting an increasing number of trades from Paulson's market-timing accounts, identified their broker codes as associated with market-timing accounts and would not allow other trades submitted with those broker codes. Thus, after sending the notes to Davis, the brokers repeatedly asked Davis to approve new rep codes and told Davis that they wanted new rep codes in order to hide from mutual funds that monitored for brokers engaged in excessive market timing.

**DAVIS APPROVED THE NEW JOINT BROKER CODES
AND FAILED TO MONITOR HOW THEY ARE USED**

At first, Davis rejected those requests several times and told the three brokers that he would not approve new broker codes, unless they could provide him with a legitimate purpose for the new codes. Subsequently, the brokers again asked Davis to approve new joint broker codes and provided him with a legitimate reason – to help "segregate and distinguish" the market-timing trades from other trades. In fact, the brokers intended to use the new broker codes to evade detection by the mutual fund companies.

On July 31, 2003, Davis approved the new broker codes. Four new joint broker codes were established for the brokers. One of the three brokers acted as an assistant for the other two brokers and to compensate him for this assistance, the codes were

established as "joint" broker codes. The names associated with these joint broker codes were the first names of the brokers joined together and then spelled backwards.

For an approximately five-week period beginning on August 7, 2003, the Park Avenue branch brokers began to use these new broker codes and broker names for some of their market-timing accounts at Paulson. Additionally, they continued to use their old broker codes and broker names for other market-timing accounts at Paulson. In part, the brokers used the new broker codes and broker names for the purpose of evading detection by mutual funds that might be monitoring for market timers. Using the new broker codes and broker names, the Park Avenue branch brokers made approximately 48 mutual fund trades for their market-timing clients, earning the clients approximately \$64,000 in profits. Davis failed to monitor how the brokers used the new codes, or for what purposes, after he approved the creation of the new rep codes.

**DAVIS FAILED TO REASONABLY SUPERVISE THE BROKERS,
IN VIOLATION OF RULE 3010 AND 2110**

When Davis approved the new broker codes on July 31, 2003, he knew that the brokers were engaging in extensive market-timing activity. Davis also knew that the clients and the brokers had requested new broker codes for an improper purpose. Under the circumstances, it was foreseeable that the brokers would misuse the new broker codes as they did. Nevertheless, Davis did not monitor the brokers' activity to ensure that the brokers did not use the new broker codes for an improper purpose, after he approved the creation of new broker codes. As a result, Davis violated NASD Conduct Rules 3010 and 2110.

SANCTIONS

Davis consents to the imposition, at a maximum, of the following sanctions:

1. A fine of \$25,000; and
2. A suspension from associating with any member firm in any supervisory or principal capacity for 23 business days.

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

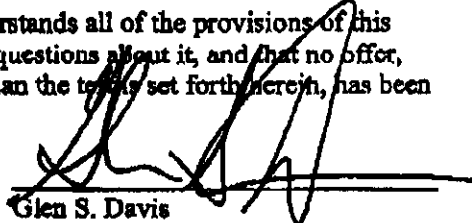
III.

OTHER MATTERS

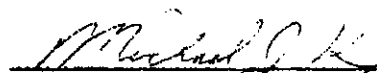
- A. Davis understands that he may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Davis understands that he may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by NASD, nor does it reflect the views of NASD, or its staff.
- B. Davis agrees to pay any monetary sanctions imposed on him upon notice that this AWC has been accepted and that such payments are due and payable, and he has attached an Election of Payment form showing the method by it proposes to pay any fine imposed.
- C. Davis specifically and voluntarily waives any right to claim that he is unable to pay, now or at any time hereafter, any monetary sanction imposed in this matter.

The undersigned certifies that he 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 him to submit it.

Date: 6/13/06


Glen S. Davis
Respondent

Reviewed by:


Michael J. King, Esq.
Counsel for Respondent Glen S. Davis

Accepted by NASD

7/11/06
Date


Samuel L. Israel
Director and Chief Counsel
Department of Enforcement
on behalf of the Director of ODA,
pursuant to delegated authority