

NASD
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. ELI2004001401

TO: Department of Enforcement
NASD

RE: David Lerner Associates, Inc., Respondent
Member Firm
[BD No. 5397]

Martin Lerner, Respondent
General Securities Principal and
General Securities Representative
[CRD No. 871038]

Russell Howard Moss, Respondent
Investment Company and Variable Contracts Products Representative
[CRD No. 1124611]

Pursuant to Rule 9216 of NASD's Code of Procedure, Respondents David Lerner Associates, Inc. ("DLAI" or "the firm"), Martin Lerner ("M. Lerner"), and Russell Howard Moss ("Moss") (collectively, "Respondents") submit 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 Respondents alleging violations based on the same factual findings.

Respondents understand 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 Respondents; and
3. If accepted:
 - a. this AWC will become part of Respondents' permanent disciplinary records and may be considered in any future actions brought by NASD or any other regulator against them;
 - b. this AWC will be made available through NASD's public disclosure

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program in response to public inquiries about Respondents' disciplinary records;

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

Respondents also understand that their 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:

DLAI is a subchapter S corporation and has been a member of NASD since October 15, 1970. The firm's main office is located in Syosset, New York.

M. Lerner first became registered with NASD on August 31, 1979 through a member firm. He has been registered with NASD as a General Securities Representative ("GSR") from January 9, 1992 through the present, and as a General Securities Principal ("GSP") from September 4, 1998 through the present, through DLAI. During all relevant times, M. Lerner served as the Executive Vice-President of Sales of DLAI.

Moss first became registered with NASD as an Investment Company and Variable Contracts Products Representative ("IR") on July 26, 1983 through a member firm and has been registered with several member firms since that time. From November 29, 1999 through the present, Moss has been registered as an IR through DLAI. During all relevant times, Moss served as an Assistant Vice-President and Director of Insurance Services of DLAI.

In April 2004, DLAI entered into an AWC with NASD. The AWC contained findings that DLAI conducted sales contests in which the firm provided greater weight for contest purposes for sales of certain proprietary mutual funds or variable annuity contracts distributed or offered by DLAI, in violation of NASD's mutual fund and variable contract non-cash compensation provisions of NASD Conduct Rules 2830 and 2820, as well as NASD Conduct Rule 2110. Additionally, the AWC contained findings that DLAI failed to establish and maintain a supervisory and compliance system or procedures governing the non-cash compensation provisions, in violation of NASD Conduct Rules 3010 and 2110. DLAI was censured and fined \$100,000.

DLAI does not have any other relevant disciplinary history with the Securities and Exchange Commission, any self-regulatory organization, or any state securities regulator.

M. Lerner and Moss do not have any prior disciplinary history with the Securities and Exchange Commission, any self-regulatory organization, or any state securities regulator.

I.

WAIVER OF PROCEDURAL RIGHTS

Respondents specifically and voluntarily waive the following rights granted under NASD's Code of Procedure:

- A. To have a Formal Complaint issued specifying the allegations against them;
- 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 ("SEC") and a U.S. Court of Appeals.

Further, Respondents specifically and voluntarily waive 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.

Respondents further specifically and voluntarily waive 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

Respondents hereby accept and consent, without admitting or denying the allegations or 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:

A. Summary

Between November 1998 and February 2004, employees of DLAI failed to comply with New York State Insurance Department Regulation No. 60 governing replacement sales of life insurance and variable annuities. The regulation is intended to protect the interest of the public by: establishing minimum standards of conduct to be observed in the replacement of life insurance policies and annuity contracts by making available full and clear information on which an applicant for life insurance or annuities can make a decision in his or her own best interest; by reducing the opportunity for misrepresentation and incomplete comparison in replacement situations; and by precluding unfair methods of competition and unfair practices. During the same time period, DLAI, acting through M. Lerner and Moss (after October 1999), failed to supervise the firm's employees with a view towards preventing violations of the regulation. DLAI, M. Lerner and Moss also violated NASD's principal registration requirements because Moss was functioning as a principal at DLAI without being properly registered in that capacity.

B. Regulation No. 60

New York State Insurance Department Regulation No. 60 (11 N.Y.C.R.R. 51) ("Reg. 60"), which became effective on November 10, 1998, establishes certain standards of conduct to be observed in the replacement or proposed replacement of annuity contracts and life insurance policies in the State of New York. The regulation seeks to ensure that applicants for life insurance and annuities have full and clear information prior to making a decision to replace an existing policy or contract. The regulation aims at reducing the opportunity for misrepresentation and incomplete comparison in replacement situations.

The regulation requires documentation of two separate interactions with a customer before a replacement can be completed. In step one, the customer is provided with a "Definition of Replacement" form designed to disclose to the customer that a replacement is being considered. Additionally, the customer authorizes, through a "Client Authorization" form, the collection of information pertaining to the existing life insurance policy or annuity contract proposed for replacement.

In step two, the customer is provided with a "Disclosure Statement" setting forth information comparing the old and new life insurance policies or annuity contracts, including the primary reason(s) for recommending the new policy or contract and why the existing policy or contract cannot meet the applicant's objectives. The customer is also provided with an "Important Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts" ("Important Notice"), which, among other things, reminds the customer to: (1) carefully study the Disclosure Statement until the customer understands fully the effects of the proposed replacement; (2) ask the company or agent from whom the customer purchased the existing life insurance policy or annuity contract to review with the customer the transaction and the Disclosure Statement; and (3) consult with his/her tax advisor because there may be unfavorable tax implications associated with the contemplated replacement. The customer must sign and date an acknowledgement stating that the customer received and read the completed Disclosure Statement and Important Notice before signing the application for the new annuity contract or life insurance policy.

C. DLAI's Failure to Comply With Reg. 60

During the period from November 1998 through February 2004, certain DLAI employees failed to comply with the required Reg. 60 replacement process. Specifically, during the relevant time period, in contravention of Reg. 60, certain DLAI registered representatives and associated persons instructed customers to sign, but leave undated, all of the Reg. 60 documents, including the Definition of Replacement form, Client Authorization form, Disclosure Statement, and Important Notice, during their first initial meeting with each customer to discuss a potential variable life insurance or variable annuity replacement sale. Subsequently, those DLAI employees would forward the Reg. 60 documentation to TK, an unregistered DLAI employee in the firm's main office who was responsible for processing all Reg. 60 paperwork.

TK, in turn, with the knowledge of certain members of DLAI management, routinely completed the required information on the pre-signed Reg. 60 paperwork. This included filling in the necessary "Agent's Statement" on the Disclosure Statement. The Agent's Statement was required to list the primary reason(s) for recommending the new life insurance policy or annuity contract and why the existing life insurance policy or annuity contract cannot meet the applicant's objectives. TK completed the required Agent's Statement by consistently listing standard boilerplate information, without having any direct knowledge or understanding of the reason for the proposed replacements in each particular case.

Additionally, TK, with the knowledge of certain members of DLAI management, routinely inserted dates on the pre-signed Reg. 60 documentation in order to create the appearance that Reg. 60 and the required two-step procedure had been followed and that there had been an appropriate interval between the steps during which information had been obtained from the issuer of the old variable life insurance policy or variable annuity contract. TK reviewed, completed, and processed all Reg. 60 documentation without any principal ever reviewing the Reg. 60 documentation for compliance with the regulation.

By having their clients during the initial meeting pre-sign without dating the incomplete Reg. 60 documentation, which was later completed and dated by TK, in many instances DLAI's sales force was able to effect variable life insurance or variable annuity replacements sales before their clients ever received or reviewed the completed Reg. 60 documentation, including the required Disclosure Statement and Important Notice.

In many instances the firm's sales force provided customers considering a variable life insurance or variable annuity replacement with a variety of disclosure materials other than the required Reg. 60 documentation during their meetings with those clients to compare the existing policy or contract with the proposed replacement product. Such alternative materials included: (1) in-force summaries of the current insurance policy or annuity contract, (2) re-projections of the current life insurance policy, (3) hypothetical illustrations of the proposed replacement insurance policy, and (4) historical performance illustrations of the proposed replacement variable annuity contract.

Such alternative disclosure materials, while utilized to provide comparative information, do not fulfill or substitute for the requirements of Reg. 60. As noted above, Reg. 60 is designed to ensure that customers considering a life insurance or annuity replacement are provided with a consistent and clear comparison of the differences between the existing product and the proposed replacement product so that they can make a fully informed decision as to whether the replacement is in their best interest and so that they are not subject to misrepresentations or incomplete comparisons when deciding whether a replacement is in their best interest. Reg. 60 is specifically designed so that customers are not limited to piecing together and reviewing numerous disclosure materials, such as in-force summaries, hypotheticals, and illustrations, in order to make an informed decision as to whether to effect a replacement.

Certain DLAI employees uniformly attributed their Reg. 60 deficiencies to a lack of supervision and training by the firm in this area. Those employees indicated that they were instructed by certain members of management to have their customers sign, but not date, all of the Reg. 60 forms during their initial meeting to discuss a proposed replacement and to have TK complete and process those forms, including filling in the Agent's Statement on the Disclosure Statement and inserting all necessary dates. Those employees also indicated that they never received any training on Reg. 60 compliance during their periods of employment at DLAI.

Certain DLAI employees also attributed their Reg. 60 non-compliance to an atmosphere of pressure at the firm to effect as many replacements as possible and to expedite the processing of such replacements. For example, those employees noted that, during firm sponsored sales contests, participants were provided with bonus points for "PUPs," which stood for "picking up policies" with a view towards potential replacements of those policies. Those employees also noted that the required two-step process of Reg. 60 was time-consuming and that the alternative process followed at the firm was an attempt to shorten that process.

DLAI effected at least 527 variable life insurance replacement sales to New York State residents and generated total revenue of at least \$3,431,829 from those sales during the relevant time period. DLAI effected at least 259 variable annuity replacement sales to New York State residents and generated total revenue of at least \$1,372,787 from those sales during the relevant time period.

During that same time period, by having customers pre-sign without dating the incomplete Reg. 60 documentation, DLAI failed to prepare and maintain accurate records of variable life insurance and variable annuity replacement sales subject to Reg. 60.

D. Principal Registration Requirements

NASD Membership and Registration Rule 1021(a) provides that "[a]ll persons engaged or to be engaged in the investment banking or securities business of a member who are to function as principals shall be registered as such" Section (b) of Rule 1021 defines a principal as:

Persons associated with a member, enumerated in subparagraphs (1) through (5) hereafter, who are actively engaged in the management of the member's

investment banking or securities business, including supervision, solicitation, conduct of business or the training of persons associated with a member for any of these functions are designated as principals. Such persons shall include . . . (2) Officers . . . (5) Directors of Corporations.

E. DLAI's, M. Lerner's and Moss' Violations of the Principal Registration Requirements

During the period November 1999 through February 2004, Moss functioned as a principal of DLAI without being properly registered in a principal capacity. Specifically, Moss, as Assistant Vice-President and Director of Insurance Services of DLAI, directly supervised TK. He was also, from time to time, delegated supervisory tasks over the firm's branch insurance specialists who were *registered representatives assigned to assist the firm's sales force in effecting variable life insurance and variable annuity sales*. As such, Moss shared responsibility with M. Lerner for supervising the variable life insurance and variable annuity replacement sales of DLAI's sales force.

During the same time period, DLAI, acting through M. Lerner, DLAI's Executive Vice-President of Sales and Moss' direct supervisor, permitted Moss to function as a principal without being properly registered in a principal capacity.

F. Supervision Requirements

Pursuant to NASD Conduct Rule 3010(a), an NASD member is obligated to "establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of [the] Association. Final responsibility for proper supervision shall rest with the member." Broader than its counterpart under the Securities Exchange Act of 1934, Section 15(b)(4)(E), NASD Conduct Rule 3010(a) imposes an "affirmative obligation" on NASD member firms to establish supervisory systems. *Bradford John Titus*, Exchange Act Release No. 38029, 1996 SEC LEXIS 3341, *12, n.14 (rejecting claim that Article III, Section 27 of the NASD's Rules of Fair Practice [now NASD Conduct Rule 3010] is "substantially identical" to Exchange Act Section 15(b)(4)(E)). Thus, NASD Conduct Rule 3010(a) requires member firms to take a prophylactic approach, instead of a reactive approach, with respect to compliance.

G. M. Lerner's and Moss' Failure to Supervise the Firm's Sales Force

During the period of the misconduct charged, M. Lerner was the Executive Vice-President of Sales and Moss was an Assistant Vice-President and Director of the Insurance Department who reported directly to M. Lerner, and both shared responsibility for supervising the variable life insurance and variable annuity replacement sales of the firm's sales force. Despite their shared authority in this area, neither M. Lerner nor Moss ever reviewed the Reg. 60 documents submitted by the firm's registered representatives and associated persons or ever reviewed the Reg. 60 paperwork being completed by TK, the firm's unregistered employee in charge of processing replacement-related documentation. The firm's branch insurance specialists consistently indicated that Moss himself

instructed them to follow the process of having the customers sign, but leave undated, all of the Reg. 60 documentation during their initial meetings with customers to discuss a proposed replacement and to then send the paperwork to TK to complete the necessary information and insert required dates.

H. DLAI's, M. Lerner's, and Moss' Violations

1. Reg. 60 and Related Books and Records

During the period from November 1998 through February 2004, DLAI, by effecting variable life insurance and variable annuity replacement sales to New York State residents in contravention of Reg. 60, failed to observe high standards of commercial honor and just and equitable principles of trade. By reason of the foregoing, DLAI violated NASD Conduct Rule 2110. During that same time period, DLAI also failed to prepare and maintain accurate books and records of variable life insurance and variable annuity replacement sales subject to Reg. 60. By reason of the foregoing, DLAI violated Section 17(a) of the Securities Act of 1934, and Rules 17a-3 and 17a-4 promulgated thereunder, and NASD Conduct Rules 2110 and 3110.

2. Registration

During the period November 1999 through February 2004, Moss functioned as a principal of DLAI without being properly registered in a principal capacity. During that same time period, DLAI, acting through M. Lerner, permitted Moss to function as a principal without being properly registered in a principal capacity. By reasons of the foregoing, DLAI, M. Lerner and Moss violated NASD Membership and Registration Rule 1021 and NASD Conduct Rule 2110.

3. Failure to Reasonably Supervise the Firm's Sales Force

During the period from November 1998 through February 2004, DLAI, acting through M. Lerner, and during the period November 1999 through February 2004, DLAI, acting through Moss, failed to reasonably supervise the activities of its associated persons and registered representatives related to variable life insurance and variable annuity replacement sales subject to Reg. 60. By reason of the foregoing, DLAI, M. Lerner, and Moss violated NASD Conduct Rules 3010 and 2110.

I. Sanctions

Respondents also consent to the imposition, at a maximum, of the following sanctions:

1. A censure against DLAI;
2. A monetary fine in the amount of \$400,000 against DLAI, of which:
 - a. \$25,000 shall be joint and several with M. Lerner; and
 - b. \$25,000 shall be joint and several with Moss;

3. A suspension against DLAI from engaging in any variable life insurance or variable annuity business for 30 calendar days for prospective customers who are not DLAI customers as of the date this AWC is issued;
4. A suspension against M. Lerner from associating with any member firm in any supervisory or principal capacity for 20 business days; and
5. A suspension against Moss from associating with any member firm in any capacity for 20 business days.

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

III.

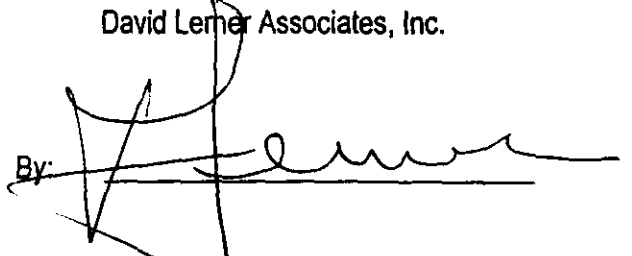
OTHER MATTERS

- A. Respondents understand that they may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Respondents understand that they 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. Respondents agree 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 they propose to pay any fines imposed.
- C. Respondents specifically and voluntarily waive any right to claim that they are unable to pay, now or at any time hereafter, any monetary sanctions imposed in this matter.
- D. Respondent Moss understands that if he is barred or suspended from associating with any NASD member, he becomes subject to a statutory disqualification as that term is defined in Section 3(a)(39) of the Securities Exchange Act of 1934, as amended. Accordingly, he may not be associated with any NASD member in any capacity, including clerical or ministerial functions, during the period of the bar or suspension. (See NASD Rule 8310 and IM-8310-1.)

Respondents certify that they have read and understand all of the provisions of this AWC and have 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, have been made to induce them to submit it.

1/11/06
Date

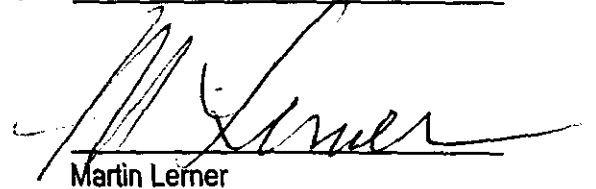
David Lerner Associates, Inc.

By: 

Name: David Lerner

Title: President

1/13/06
Date

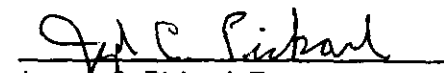

Martin Lerner

Date

Russell Howard Moss

Reviewed by Counsel for Respondents:

1/11/06
Date


Joseph C. Pickard, Esq.,
(counsel for DLAI)

Date

Ruthann Niosi, Esq.,
(counsel for M. Lerner and Moss)

Respondents certify that they have read and understand all of the provisions of this AWC and have 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, have been made to induce them to submit it.

David Lerner Associates, Inc.

Date

By: _____

Name: _____

Title: _____

Date

Martin Lerner

JAN 13 06

Date



Russell Howard Moss

Reviewed by Counsel for Respondents:

Date

Joseph C. Pickard, Esq.,
(counsel for DLAI)

Date

Ruthann Niosi, Esq.,
(counsel for M. Lerner and Moss)

Respondents certify that they have read and understand all of the provisions of this AWC and have 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, have been made to induce them to submit it.

David Lerner Associates, Inc.

Date

By: _____

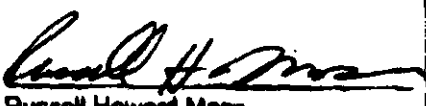
Name: _____

Title: _____

Date

Martin Lerner

Date

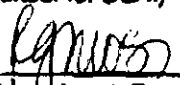

Russell Howard Moss

Reviewed by Counsel for Respondents:

Date

Joseph C. Pickard, Esq.,
(counsel for DLA)

Date


Ruthann Niosi, Esq.,
(counsel for M. Lerner and Moss)

Accepted by NASD:

2/7/06
Date

Jon S. Batterman

Jon S. Batterman
Deputy Regional Chief Counsel
NASD, District 10
Two Jericho Plaza
Jericho, NY 11753
Signed on behalf of the Director of ODA,
by delegated authority

NASD Deputy District Director

Patricia Cappeto
NASD, District 10
Two Jericho Plaza
Jericho, New York 11753