



# Notices To Members

## Notices

<b>02-73</b>	SEC Approves New Rules and Rule Amendments Concerning Security Futures; <b>Effective Date: October 15, 2002</b>	745
<b>02-74</b>	NASD Requests Comment on its Public Information Review Initiative	797
<b>02-75</b>	NASD Provides Additional Information on the Trading Activity Fee	809
<b>02-76</b>	NASD Issues Interpretive Guidance to the Trade Reporting and Compliance Engine Rules (TRACE Rules)	815
<b>02-77</b>	SEC Approves Rule Establishing New Registration Category for Proctors of In-Firm Delivery of the Regulatory Element	835
<b>02-78</b>	NASD Adopts Amendments to Rule 3011 to Require Members to Provide to NASD Contact Information for an Anti-Money Laundering Compliance Person(s)	839
<b>02-79</b>	NASD Notice of Meeting and Proxy	843
	<b>Disciplinary Actions</b>	
	Reported for November	851
	<b>For Your Information</b>	869

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# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Legal & Compliance  
Operations, Trading and Training  
Registered Representatives  
Senior Management

## KEY TOPICS

Security Futures

## INFORMATIONAL

### Business Conduct and Responsibility Rules

SEC Approves New Rules and Rule Amendments Concerning Security Futures; **Effective Date: October 15, 2002**

#### Executive Summary

On October 15, 2002, the Securities and Exchange Commission (SEC) approved rule changes by NASD that both create and amend certain rules and interpretive materials to address the requirements for NASD members engaging in a security futures business. These rule changes:

- ▶ amend registration rules to expand several registration categories to include engaging in and supervising security futures transactions;
- ▶ amend Rule 1060 (Persons Exempt from Registration) to exempt from NASD registration persons associated with a member who are already registered with a registered futures association and whose functions are related exclusively to security futures transactions;
- ▶ create Rule 2865 (Security Futures Rule) to regulate security futures sales practices and amend Interpretive Material 2310-2 (Fair Dealing with Customers) to refer to new Rule 2865 regarding security futures sales practices;
- ▶ amend Interpretive Material 2110-3 (Front Running Policy) to add block trading in single stock futures to the prohibition against front running;
- ▶ amend NASD's advertising rule – Rule 2210 (Communications with the Public) and create new Interpretive Material 2210-7 (Guidelines for Communications with the Public Regarding Security Futures) to regulate communications with the public regarding security futures;

- ♦ amend Rule 3010(b)(2) (the Taping Rule) to recognize the ability of futures regulators to expel a member from the futures industry for futures-related sales practice violations;
- ♦ amend Rule 3010(e) (Qualification of Job Applicants) to require firms to check the backgrounds of job applicants who have previously worked in the futures industry;
- ♦ amend Rule 3050 (Transactions for or by Associated Persons) to require associated persons to notify their member firm when they open certain futures accounts or engage in certain security futures transactions; and
- ♦ amend Rule 3370 (Prompt Receipt and Delivery of Securities) to exempt security futures from the affirmative determination requirement.

These changes are included with this *Notice* (see Attachment A). They become effective October 15, 2002.

This *Notice* also explains that adding a security futures business may constitute a material change of business and describes the factors a member should consider in determining whether engaging in a security futures business constitutes a material change that would require the member to file a continuing membership application with NASD and obtain prior approval before engaging in a security futures business. The *Notice* also clarifies that best execution obligations apply to transactions in security futures. In addition, the *Notice* explains that members engaged in a security futures business must comply with their obligations in the analyst rule, Rule 2711 (“Research Analysts and Research Reports”).

## Questions/Further Information

Questions concerning this *Notice* may be directed to the Office of General Counsel, NASD Regulatory Policy and Oversight: Gary L. Goldsholle, Associate General Counsel, (202) 728-8104; Alan Lawhead, Associate General Counsel, (202) 728-8853; or Patricia Albrecht, Assistant General Counsel, (202) 728-8026.

## Background

The Commodity Futures Modernization Act of 2000 (CFMA) lifted the ban on the trading of security futures, i.e., single stock and narrow-based stock index futures (“security futures”).<sup>1</sup> The CFMA defines security futures both as securities under the federal securities laws,<sup>2</sup> and as futures contracts for purposes of the Commodity Exchange Act (CEA).<sup>3</sup> Accordingly, the SEC and the Commodity Futures Trading Commission (CFTC) have joint jurisdiction over the intermediaries and markets that trade security futures products.

Because they are subject to regulation both as securities and as futures contracts, security futures must be traded on trading facilities<sup>4</sup> and through intermediaries that are registered with both the SEC and the CFTC. Broker/dealers that wish to conduct a business in security futures are required to notice register with the CFTC as Futures Commission Merchants (FCMs) or Introducing Brokers (IBs).<sup>5</sup> Similarly, FCMs and IBs are required to notice register as broker/dealers if they wish to conduct a business in security futures.<sup>6</sup> Firms that are fully registered as both FCMs or IBs and broker/dealers may engage in security futures transactions without any notice registration.

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NASD has amended certain rules and interpretive materials and created new rules and interpretive materials to address security futures.<sup>7</sup> This *Notice* explains and describes: (1) changes to the qualifications and testing requirements; (2) the provisions of new Rule 2865 and other rule changes; (3) that best execution obligations apply to transactions in security futures; (4) that adding a security futures business constitutes a material change of business under NASD rules and the implications of adding this new business; and (5) that members engaged in a security futures business must comply with their obligations in Rule 2711.

## I. Qualification and Training

### A. *Changes to Registration; Continuing Education for Existing Registrants*

Under the CFMA, self-regulatory organizations (SROs) are responsible for ensuring that individuals engaging in a security futures business are properly qualified.<sup>8</sup> To accommodate the introduction of security futures, several registration categories have been modified to include the activities of engaging in and supervising securities futures. In general, where a registration category permits an individual to engage in an options business, that category has been modified to permit activity in security futures. Specifically, the modified categories are the Series 4 (Registered Options and Security Futures Principal (replaces Registered Options Principal)), Series 9/10 (Limited Principal – General Securities Sales Supervisor),<sup>9</sup> Series 7 (General Securities Representative), and Series 42 (Limited Representative – Options and Security Futures (replaces Limited Representative – Options)).<sup>10</sup>

Until December 31, 2006, persons who are currently registered in the above-mentioned categories or who become registered in one of these categories prior to the implementation of the revised examinations addressing security futures and who want to engage in a security futures business must complete a firm-element continuing education requirement addressing security futures before engaging in any security futures business. As discussed below, the continuing education requirement has been instituted as an alternative to retesting and is discussed below.

The opportunity for eligible registrants to qualify to engage in a security futures business by completing a firm-element continuing education requirement ends on December 31, 2006. After that date, if an eligible registrant has not taken the firm element continuing education program and wants to begin participating in a security futures business, that registrant must take a revised qualification examination before engaging in a security futures business.

We recognize that this is the first time NASD has mandated a particular firm-element continuing education program.<sup>11</sup> Traditionally, member firms have determined the nature and content of their firm-element continuing education programs. The introduction of security futures in the United States, however, is an extraordinary situation. Following a nearly 20-year ban, securities professionals will be able to trade products that are both securities and futures. Accordingly, securities professionals may not be sufficiently familiar with the different risks, trading characteristics, and terms and nomenclature of these products, including the fact that the products are subject to the joint jurisdiction of the

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SEC and CFTC. Consequently, we have determined that firm element continuing education is the most effective method of ensuring that existing registrants are properly informed about security futures.<sup>12</sup>

To facilitate firms' compliance with the continuing education requirement, we have developed with the National Futures Association (NFA) and the Institute for Financial Markets an internet-based training program that firms may use to satisfy the firm element requirement. Attached to this *Notice* is an outline of the content of the continuing education program. (See Attachment B). Registered personnel may access the training through NASD's Web Site at <http://www.nasd.com>. Use of the NASD/NFA program, however, is not mandatory. Firms may develop their own firm element training programs following the NASD syllabus. Firms also may engage other continuing education providers to deliver the training, provided that the training covers all of the subjects in the NASD syllabus. NASD and NFA are offering a web-based training program because we recognize that many firms may not have the resources or expertise to develop such programs "in-house" or in a timely manner. NASD is offering the training program free of charge. More information about the NASD/NFA continuing education program can be found at the NASD Web Site.

*B. Development of New Qualification Examinations*

We are currently working with industry representatives and other SROs to develop revised qualification examination questions on security futures. These new questions on security futures will be added to the Series 4, Series 9/10, and Series 42.<sup>13</sup>

We also intend to offer a new Series 43 examination for general securities representatives seeking to engage in a security futures business. Once the Series 43 is developed, new applicants seeking to act as a general securities representative may choose to take only the Series 7, or, if they intend to engage in a security futures business, the Series 7 and Series 43 examinations. After the Series 43 examination is developed, persons taking only the Series 7 will not be permitted to engage in a security futures business, nor will they be able to qualify to engage in a security futures business by completing a firm-element continuing education program.<sup>14</sup> Firm-element continuing education programs will be an option available only for persons who are registered as a general securities representative before the Series 43 examination becomes available.

We are not amending the Series 24 – General Securities Principal examination. The Series 24 does not permit a principal to supervise options activity, and consequently, we do not intend to amend the examination to allow such persons to supervise security futures activity.

NASD anticipates that the new and revised qualification examinations will be available six months after trading in security futures commences.

In addition, NASD is allowing individuals who have passed the Series 30 (NFA's Branch Manager Examination) to supervise security futures activities. This is principally an accommodation to members that are registered as a broker/dealer and an FCM or IB, which are likely to have Series 30 personnel in their futures business. Rule 1022(f) requires each Registered Options and Security Futures Principal to pass "the

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appropriate Qualification Examination for Registered Options and Security Futures Principal, *or an equivalent examination acceptable to NASD.*" NASD has deemed the Series 30 examination to be an "equivalent examination acceptable to NASD" for purposes of supervising security futures activities. Persons who have passed the Series 30 and, if appropriate, the necessary firm-element continuing education, may supervise a member's security futures activities. Such persons, however, may not supervise options activities.

*C. Limited Exemption from Registration for Certain Associated Persons Engaged Exclusively in Security Futures Transactions*

We are also amending Rule 1060 (Persons Exempt from Registration) to exempt from NASD registration requirements associated persons whose securities activities are related solely and exclusively to transactions in security futures, provided that such persons are registered with a registered futures association. The NFA currently is the only registered futures association. This rule change recognizes that certain persons in a firm that is a broker/dealer and either an FCM or IB, who currently engage solely in a commodities business, may seek to expand their activities into security futures. The rule change has been made to avoid having such persons be required to register as representatives. While those persons are not required to register as representatives, they must follow NFA rules concerning, among other things, continuing education.

## **II. Security Futures Rule and Other Changes to Rules and Interpretive Materials**

NASD has developed rules regulating members' activities in security futures. One of the underpinnings of the CFMA is that the regulation of security futures should be comparable to the regulation of options.<sup>15</sup> As noted below, that principle has guided the rule and interpretive material changes addressing the introduction of security futures.

### **Rule 2865 – Security Futures Rule**

The principal CFMA-related rule change is Rule 2865 (Security Futures Rule), which is based on the options rule, Rule 2860 (Options Rule).<sup>16</sup> Highlighted below are the new rule's major requirements.

#### *A. Opening of Accounts*

Rule 2865(b)(16) provides that a member may not open a security futures account unless the member follows specific procedures. These procedures generally include:

- ◆ providing the customer with the security futures risk disclosure statement;
- ◆ gathering specific, detailed information regarding the customer's financial situation and investment objectives;
- ◆ obtaining written approval for security futures trading in the account by a principal qualified to supervise security futures activities based upon the information gathered; and
- ◆ obtaining, within 15 days after the customer's account has been

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approved to trade security futures, the customer's verification of the background and financial information upon which the account was approved and a written agreement that the customer has received a copy of the security futures risk disclosure statement, agrees to be bound by NASD's security futures trading rules, and agrees not to violate applicable security futures position limits.

*B. Delivery of Security Futures Risk Disclosure Statement<sup>17</sup>*

In general, the requirements for delivery of the security futures risk disclosure statement are comparable to the requirements for the delivery of the options disclosure document. Under Rule 2865(b)(11), every member must deliver the security futures risk disclosure statement to each customer at or prior to the time such customer's account is approved for trading security futures. The SEC approved the security futures risk disclosure statement on October 10, 2002. Additionally, as noted above, under Rule 2865(b)(16)(D), a member must within 15 days after a customer's account has been approved for trading in security futures receive a written agreement from each customer that, among other things, states that the customer has received a copy of the security futures risk disclosure statement.

Copies of the security futures risk disclosure statement may be obtained from NASD Media Source at (301) 590-6500, or from the NFA. Electronic copies may be downloaded from NASD's Security Futures Web Page at [www.nasdr.com/futures.asp](http://www.nasdr.com/futures.asp), or NFA's Web Site.

*C. Suitability*

When recommending security futures to a customer, a member must employ a heightened suitability standard similar to the suitability standard for options.<sup>18</sup> This heightened standard recognizes that security futures carry a higher degree of risk to a customer than many other securities products. Specifically, if an associated person recommends a security futures transaction, Rule 2865(b)(19) imposes the additional requirement that the associated person have a reasonable basis for believing "that the customer has such knowledge and experience in financial matters that the customer may reasonably be expected to be capable of evaluating the risks of the recommended transaction and is financially able to bear the risks of the recommended position in the security future." To provide consistency with the suitability standard for security futures adopted by the NFA,<sup>19</sup> our security futures standard also explicitly includes recommendations of "trading strategies."

In addition, the suitability obligations applicable to recommendations to institutional customers, as specified in Interpretive Material 2310-3, apply to transactions in security futures and options.

*D. Discretionary Accounts*

Discretionary account procedures for security futures are comparable to those for discretionary accounts for options. Notably, as with options, Rule 2865(b)(18) provides that the customer must specifically authorize in writing security futures trading conducted on a discretionary basis in the account. Even those accounts that are permitted to trade options cannot trade security

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futures unless a new written discretionary account authorization specifically authorizing trading of security futures is on file.

#### *E. Statements of Account*

Under Rule 2865(b)(15), members must send customers an account statement at least each month where there has been an entry in the account during the prior month with respect to a security futures contract. Also, members must send quarterly account statements to all customers that have an open security futures position or money balance in the account.

A customer account statement for a margin account must provide the market price, mark-to-market value and nominal value of each security futures position and the mark-to-market price and market value of other security positions in the margin account, the total market value of all positions in the account, the outstanding debit or credit balance in the account, and the account equity. In addition, an account statement must inform the customer that further information on commissions and other charges related to the security futures transactions covered in the statement have been included in the previously furnished transaction confirmations and that such information will be made available to the customer promptly upon request. Also, the statement must bear a legend requiring that the customer promptly report any material change in the customer's investment objectives or financial situation.

#### *F. Confirmations*

The SEC has adopted an amendment to Exchange Act Rule 10b-10 providing confirmation requirements for security

futures transactions conducted in futures accounts.<sup>20</sup> In view of the SEC's amendment, NASD currently is not amending its confirmation requirements to address transactions in security futures. However, irrespective of whether security futures are transacted in a futures account or a securities account, NASD members should ensure that the confirmations they provide to their customers for security futures transactions meet the appropriate requirements provided in Exchange Act Rule 10b-10.

#### *G. Maintenance of Records*

As part of their recordkeeping obligations, members are required under Rule 2865(b)(17) to maintain at their principal place of business or another designated principal office a separate record of all security futures-related complaints, through which these complaints can easily be identified and retrieved. In addition, Rule 2865(b)(17) requires members to maintain the background and financial information of any customer who has been approved for security futures trading at both the branch office servicing the customer's account and at the principal supervisory office having jurisdiction over that branch office. This recordkeeping provision is almost identical to the recordkeeping provision in the Options Rule.<sup>21</sup>

#### *H. Restrictions in Security Futures Transactions*

Rule 2865(b)(8) provides that NASD has the authority to impose on members any restrictions on security futures transactions if NASD deems the restrictions are necessary to maintain a fair and orderly market in security futures or in the underlying securities covered by those security futures or are otherwise

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necessary in the public interest or for the protection of investors. This provision is substantively similar to the provision on restrictions of option transactions in the Options Rule.<sup>22</sup>

*I. Security Futures Transactions and Reports by Market Makers in Listed Securities*

Under Rule 2865(b)(24), every member that is an off-board market maker in a security listed on a national securities exchange must report transactions involving 50 or more security futures contracts on such listed securities that are for the direct or indirect benefit of: (1) the member; or (2) any associated person or other employee of the member who is directly involved in the purchase or sale of the underlying security for the firm's proprietary account, is responsible for supervising such sales, or has information on the member's proprietary account in which the underlying security is traded. This provision applies to all security futures transactions, including transactions executed on an exchange in which the member belongs.

*J. Trading Ahead of Customer Orders*

Under Rule 2865(b)(25), every member must exercise due care to avoid trading ahead of customer security futures orders in a proprietary account or other account in which the member or an associated person has a direct or indirect interest. The prohibition is required only when a member has gained knowledge of or reasonably should have gained knowledge of the customer's order prior to the transmission of the member's order for a proprietary account or for any account in which it or any associated person has an interest.

The provision against trading ahead of customer orders is based on the NFA's

Interpretive Notice regarding obligations to customers and other market participants.<sup>23</sup> The NFA's Interpretive Notice gives two examples of when a firm would reasonably not be aware of a customer's order: (1) when a customer's order originates in a different branch office than the firm's proprietary order; and (2) when the firm's trading department does not have access to information about customer orders. We believe that these two situations are also examples of when a member would not violate the provisions in Rule 2865(b)(25). Moreover, generally there may be additional situations in which a member reasonably would not be aware of a customer's order for purposes of applying the rule. In those situations, the member would not violate the rule if it transmits a proprietary order to a securities exchange before a customer's order.

**Interpretive Material 2110-3 (IM-2110-3) – Front Running Policy**

NASD's front running policy, IM-2110-3, prohibits members and associated persons from trading options or an underlying security when they have material non-public market information concerning an imminent block transaction in the underlying security or in the overlying option. The front running policy applies to members' proprietary accounts, accounts in which members or associated persons have an interest or discretionary authority, and customer accounts when a member or an associated person of a member has shared material, non-public market information with a customer.

We have amended this policy to apply to security futures in the same manner that it applies to options. For example, when a member has material, non-public market information concerning an

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imminent block transaction in a stock, the member may not to trade the single-stock future overlying that stock in its proprietary account, other accounts in which it has an interest or discretionary authority, or in a customer's account if the member has shared the material, non-public information with the customer. The purpose of this amendment is to prohibit broker/dealers from trading security futures at a profit when they have material, non-public market information concerning a stock or from trading a stock at a profit when they have material, non-public market information concerning a security future. Once the material, non-public market information has been made publicly available, however, the front running policy restrictions no longer apply.

**Rule 2210 – Communications with the Public and Interpretive Material 2210-7 (IM 2210-7) – Guidelines for Communications with the Public Regarding Security Futures**

Rule 2210 (the Advertising Rule) has been amended to apply many of that rule's standards to security futures communications. In addition, new IM-2210-7 has been added to address additional advertising requirements for security futures. We have adopted this approach rather than create a stand-alone security futures advertising rule because we believe it will be easier for members to follow a modification of the general advertising rule.<sup>24</sup>

*A. Rule 2210 – Communications with the Public*

Under the Advertising Rule, only a principal qualified to supervise security futures activities can approve advertisements and sales literature concerning

security futures.<sup>25</sup> As with the pre-use filing requirements for options communications, a member must file its security futures advertisements with NASD's Advertising Regulation Department (Department) or another self-regulatory organization of which it is a member that has comparable standards applicable to security futures at least 10 days prior to use. NASD has determined that NFA's advertising rules are comparable. Thus, NASD members that are also NFA members may file their advertising materials with either the Department or NFA. The Department will review the advertisement and either approve it, disapprove it, or specify changes that the member must make to use the communication.

As noted above, many of the Advertising Rule's standards apply to these communications. In particular, communications must be based on principles of fair dealing and good faith and should provide a sound basis for evaluating the facts regarding any security futures.<sup>26</sup> Exaggerated, unwarranted, or misleading statements about security futures are not allowed.<sup>27</sup> Moreover, no member may distribute any communication that the member knows or has reason to know contains misleading material.<sup>28</sup> Nor may a member omit a material fact or qualification if the omission, in light of the context of the material presented, would cause the communication to be misleading.<sup>29</sup> Communications with the public cannot contain promises of specific results, exaggerated or unwarranted claims or unwarranted superlatives, opinions for which there is no reasonable basis, or forecasts of future events that are unwarranted.<sup>30</sup> In addition, members making recommendations about security futures must generally inform the public if they make a market in the underlying

securities or if they own security futures of any recommended underlying securities.<sup>31</sup> Finally, as explained further below, security futures communications must include specific disclosures about the risks of security futures and the ability to obtain, upon written request, documents that will support any claims made in the communications.

*B. IM-2210-7 – Guidelines for Communications with the Public Regarding Security Futures*

IM-2210-7 provides additional advertising guidelines for security futures communications, including generally requiring that all communications concerning security futures be accompanied or preceded by the security futures risk disclosure statement.<sup>32</sup> IM-2210-7 also restricts the content of security futures communications, which include advertisements, sales literature, and correspondence, that are not accompanied or preceded by the security futures risk disclosure statement. Those communications must be limited to general descriptions of the security futures being offered. In addition, they may not contain statements of historical performance or projections and must contain contact information for obtaining a copy of the security futures risk disclosure statement.

Only sales literature and correspondence that is accompanied or preceded by the security futures risk disclosure statement can contain projections or historical performance information. Additionally, IM-2210-7 provides stringent standards members must follow when making projections or using historical performance data in security futures sales literature and correspondence. For example, sales literature containing projections:

- ▶ cannot suggest the certainty of future performance;
- ▶ must clearly establish the performance parameters; and
- ▶ must reflect all relevant costs, including commissions in the projections, and disclose the risks involved in the proposed transactions.

Sales literature containing historical performance information must, among other things:

- ▶ confine historical performances to a specific “universe” that can be fully isolated and that covers at least the most recent 12-month period;
- ▶ include the date and price of each recommendation or transaction at the end of the period or when liquidation was suggested or effected;
- ▶ disclose all relevant costs, including commissions; and
- ▶ have a principal qualified to supervise security futures activities ratify that the records or statistics fairly represent the status of the recommendations or transactions reported upon.

These requirements are similar to provisions in the options advertising rule and also are substantially similar to the NFA’s requirement regarding communications with the public for security futures.<sup>33</sup>

IM-2210-7 also requires three specific disclosures about security futures. First, if the communication refers to the potential advantages of security futures, the communication must balance the statement of advantages with a reference, in the same degree of

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specificity, about the corresponding risks. This requirement of a closely balanced presentation of advantages and risks is a more exacting standard than is contained in NASD's general standard for communications with the public, which prohibits exaggerated, unwarranted, or misleading statements.<sup>34</sup> Second, the communication must include a warning that security futures are not suitable for all investors. Third, IM-2210-7 requires that the communications state that, upon request, the member will provide documents that support any claims, comparisons, recommendations, statistics, or other technical data used in the communication. All three of these disclosure requirements are similar to the requirements for options communications.<sup>35</sup>

#### **Rule 3010(b)(2) – The Taping Rule**

NASD Rule 3010(b)(2) (the Taping Rule) is applicable to NASD members if a certain percentage of their registered persons have been employed by a disciplined firm within the last three years. The Taping Rule requires subject NASD members to tape record "all telephone conversations between the member's registered persons and both existing and potential customers"<sup>36</sup> and maintain other special written procedures for supervising the telemarketing activities of all of the member's registered persons. The Taping Rule seeks to prevent registered persons who have been employed by disciplined firms from clustering together at a different firm. For purposes of the Taping Rule, a disciplined firm is one that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from NASD membership, expelled from any other securities industry self-regulatory organization, or is subject to an SEC

order revoking its registration as a broker/dealer.

In the futures industry, the NFA's taping rule requires NFA members that have a certain percentage of associated persons who have been employed by disciplined firms to tape record telephone conversations between associated persons and customers. The NFA has a three-fold definition of a disciplined firm that includes the following: (1) the firm has been charged formally by either the CFTC or NFA with deceptive telemarketing practices or promotional material; (2) the charges have been resolved; and (3) the firm has been closed and permanently barred from the industry as a result of those charges.<sup>37</sup>

NASD has incorporated this definition into the Taping Rule's existing definition of "disciplined firm" and has therefore broadened the scope of the Taping Rule to include FCMs and IBs that will be selling security futures within the group of intermediaries that can potentially meet the definition of a disciplined firm. We have adopted this amendment to promote consistency with the NFA in monitoring associated persons from disciplined firms that may engage in the security futures business.

#### **Rule 3010(e) – Qualifications of Job Applicants**

NASD Rule 3010(e) provides that members have a responsibility to investigate the good character, business repute, qualifications, and experience of a job applicant before the member applies to register that applicant with NASD. When the job applicant previously has been registered with NASD, the member must obtain a copy of the applicant's Uniform Termination Notice

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of Securities Industry Registration (“Form U-5”) that was filed by the applicant’s most recent member employer.

In light of the passage of the CFMA, Rule 3010(e) has been modified to provide that an NASD member must also review a job applicant’s employment experience to determine if the applicant has been recently employed by an FCM or an IB that is notice-registered with the SEC pursuant to Exchange Act Section 15(b)(11).<sup>38</sup> In such a case, the hiring firm would be required to review a copy of CFTC Form 8-T, Notice of Termination of Associated Person, NFA Associate, Branch Office Manager, Designated Supervisor or Principal. The Form 8-T asks for the same types of information as does the Form U-5. We anticipate that NASD members will be able to review the CFTC Form 8-T by requesting it from the applicant or the applicant’s previous employer. Rule 3010(e) has been amended because an individual’s prior experience at an FCM or an IB that conducts a security futures business may have particular bearing on his or her fitness to be sponsored by an NASD member.

In addition, Rule 3010(e) has been amended to provide members with greater flexibility in complying with its requirements. Currently, Rule 3010(e) requires members to obtain actual copies of the Form U-5 and amendments. When NASD replaced the Legacy Central Registration Depository (“CRD”) system with Web CRDs in August 1999, members received the ability to review Form U-5s and amendments via an internet connection. The Web CRD system allows members, with the applicant’s consent, to review the Form U-5 by using a pre-hire search function. The amendment recognizes the ability of members to use the advanced

functionality of Web CRD to review Form U-5s. Members, however, will be expected to be able to demonstrate compliance with the rule.

#### **Rule 3050 – Transactions for or by Associated Persons**

NASD Rule 3050(d) states that associated persons seeking to open accounts or place securities orders with a financial institution that is not their employer may not do so unless they notify their employer member and, upon written request by the employer member, obtain from the financial institution duplicate copies of certain documents concerning the orders or accounts. This rule allows NASD members to monitor the outside securities activities of their employees. The scope of this rule has been expanded to require the same notification standards for associated persons opening an account or placing an order with an FCM or IB that is notice-registered with the SEC to trade security futures.

#### **Rule 3370 – Prompt Receipt and Delivery of Securities**

Rule 3370 generally requires an NASD member, prior to accepting a short sale order from a customer in any security, to make an affirmative determination that the member can borrow or otherwise provide for delivery of the security by the settlement date.<sup>39</sup> Because the CFMA exempts transactions in security futures from the short sale provisions of Exchange Act Section 10(a)(1),<sup>40</sup> NASD has exempted security futures from the affirmative determination requirement of NASD Rule 3370.<sup>41</sup> Members, however, would be prudent to ensure that their customers can provide delivery of the security by the settlement date.

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We also have amended the definition of “bona fide fully hedged” positions in Rule 3370 to include certain long single stock futures positions in connection with short positions. These particular single stock future positions are similar to in-the-money call options, which are already included in the definition.<sup>42</sup>

### III. Best Execution

The duty of best execution applies to members’ transactions in securities, which includes transactions in security futures. The duty of best execution, which is rooted in common law agency principles and fiduciary obligations, requires that a broker/dealer seek to obtain for its customers’ orders the most favorable terms reasonably available under the circumstances.<sup>43</sup> The obligation of best execution is codified in NASD Rule 2320, which provides that in any transaction for or with a customer, a member and persons associated with a member shall use reasonable diligence to ascertain the best market for a security and buy or sell in such market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. Best execution is, however, an obligation that necessarily involves a “facts and circumstances” analysis.

In the context of security futures, when a customer’s order may be executed on two or more markets that trade security future contracts that are not materially different, members have an obligation to use reasonable diligence to ascertain the market in which the customer’s order will receive the most favorable terms. Members should consider the factors enumerated in Rule 2320 when making these decisions. If, however, a customer’s order may be executed on only one exchange, or when a customer requests that a security futures order be directed

to a particular market, members do not have to decide where to route the order.

NASD recognizes the practical necessity of members automating the handling of retail orders and the impracticability of members making order-by-order routing decisions for typical retail orders. In the context of aggregate order handling decisions, members are required to have in place procedures to regularly and rigorously examine their execution quality as a whole.

For a fuller discussion of best execution obligations, members should review the SEC’s recent interpretation regarding a broker/dealer’s best execution obligation for security futures.<sup>44</sup>

### IV. Membership Application Process

In November 2000, NASD amended its rules governing the membership application process. The amended rules provide additional guidance about the requirement that a member firm must file a continuing membership application with NASD and obtain approval prior to effecting a material change in business operations.<sup>45</sup> Specifically, the membership rules now define a “material change in business operations” as including: (1) market making, underwriting, or acting as a dealer for the first time; (2) adding business activities that require a higher minimum net capital; and (3) removing or modifying a membership agreement restriction.<sup>46</sup> All other business expansions are to be evaluated on a facts and circumstances, case-by-case basis, and firms must make a decision as to whether any particular expansion is “material” for purposes of the rules and thus requires an application. In cases requiring an application, members may not proceed with the planned expansion until NASD approves the application.

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In making the required evaluation, members should consider the criteria identified in the guidance accompanying the amended rules.<sup>47</sup> Specifically, as with any new line of business, an evaluation of all the relevant facts and circumstances should include, among other things, an assessment of the relationship between a security futures line of business and the firm's existing business; the effect that adding a security futures business will have on the firm's capital; the qualifications and experience of the firm's personnel; and the degree to which the firm's existing financial, operational, supervisory, and compliance systems can accommodate the addition of security futures.<sup>48</sup>

For purposes of analyzing whether the addition of security futures constitutes a material change in business operations, member firms are considered to fall into two general categories: firms that currently conduct an options business and those that do not.

Firms that currently conduct an options business should evaluate, based on the facts and circumstances, whether undertaking a security futures business constitutes a material change in business operations. These firms should apply the criteria identified previously for assessing the materiality of the proposed expansion.

For firms that currently do not engage in an options business, it is likely that engaging in a security futures business will constitute a material change in business operations. As to these firms, if they have assessed the potential impact on their firm of adding a security futures business and would like District Office input on the issue of whether an application is required to approve this expansion, they can consult with the District Offices by submitting notice of

their intent to engage in a security futures business to their District Office. The District Office will conduct an informal, expedited review of the firm's query that will include asking the firm questions about its existing operations and its potential security futures business. The District Office will then advise the firm regarding whether adding a security futures line of business constitutes a material change in business operations. If the District Office concludes that the firm should submit a continuing membership application, the District Office, in calculating the allotted review time, will give the firm credit for the amount of time elapsed since it provided the initial notice to the District Office.

This approach provides certain firms the opportunity to have a quick, informal assessment of whether they need to submit a continuing membership application, reduces the regulatory burden on some firms, and increases the efficiency of the continuing membership application process.

## **V. Analysts and Research Reports**

Rule 2711 ("Research Analysts and Research Reports") generally restricts the relationship between a member's research and investment banking departments; requires disclosure of financial interests in covered companies by the member's analyst and the member; requires members to disclose existing and potential investment banking relationships with subject companies; imposes quiet periods for the issuance of research reports; restricts personal trading by analysts; and requires disclosure of information that helps investors track the correlation between an analyst's rating and the stock's price movements.<sup>49</sup> The provisions of Rule 2711 are generally applicable to security

futures. For example, the restrictions on personal trading by analysts extend to trading in security futures on companies covered by the analyst. Similarly, provisions addressing disclosure of members' or research analysts' ownership interests in a security include security futures interests held by that person. And, the Rule 2711 definition of "Research Report" includes certain written or electronic communications on security futures because security futures are defined as "equity securities" under the Exchange Act.<sup>50</sup>

## Endnotes

- 1 Appendix E of Pub. L. No. 106-554, 114 Stat. 2763. Under Section 3(a)(55)(A) of the Securities Exchange Act of 1934 ("Exchange Act"), the term "security future" is defined as a contract of sale for future delivery of a single security or of a narrow-based security index. 15 U.S.C. 78c(a)(55)(A). Under Exchange Act Section 3(a)(56), the term "security futures product" is defined as a security future or an option on a security future. 15 U.S.C. 78c(a)(56).
- 2 See, e.g., Exchange Act Section 3(a)(10) (15 U.S.C. 78c(a)(10)).
- 3 The term "security future" is defined in CEA Section 1a(31) (7 U.S.C. 1a(31)) as a contract of sale for future delivery of a single security or a narrow-based security index. Under CEA Section 1a(33) (7 U.S.C. 1a(33)), the term "security futures product" is defined as a security future or an option on a security future.
- 4 See Exchange Act Section 6(g) (15 U.S.C. 78f(g)); CEA Section 5f (7 U.S.C. 7b-1).
- 5 CEA Section 4f(a)(2) (7 U.S.C. 6f(a)(2)); 66 FR 43080 (August 17, 2001).
- 6 Exchange Act Section 15(b)(11)(a)(i) (15 U.S.C. 78o(b)(11)(a)(i)); 66 FR 45138 (August 27, 2001).
- 7 NASD rules apply only to NASD members. Because FCMs and IBs that are notice-registered with the SEC are not required to become NASD members, any NASD rule changes, including the ones explained here, may not apply to them.
- 8 See generally Exchange Act Section 19(b)(7)(A) (15 U.S.C. 78s(b)(7)(A)) (mandating that national securities exchanges or national securities associations registered with the SEC develop rules effectuating the obligation of these SROs to enforce the securities laws and to propose rule changes developing, among other things, sales practices for persons who effect transactions in security futures products); see also Exchange Act Section 15A(k)(2)(D) (15 U.S.C. 78o-3(k)(2)(D)) (requiring registered futures associations that apply for registration as a limited purpose national securities association to have rules that ensure that members meet such standards of training, experience, and competence necessary to effect transactions in security futures products and are tested for their knowledge of securities and security futures products).
- 9 Rule 1022(f)(5) and (g)(3), respectively; see also changes to Interpretive Materials 1022-1 and 1022-2. IM-1022-1 replaces references to the old category, Registered Options Principals, with the new category of Registered Options and Security Futures Principals and reflects that a Registered Options and Security Futures Principal may supervise security futures trading activities. Likewise, IM-1022-2 now reflects that a Limited Principal – General Securities Sales Supervisor may also supervise security futures sales activities.
- 10 Rule 1032(a)(2)(E) and (d)(4), respectively.
- 11 See NASD Rule 1120(b)(4) (provision permits NASD to require a member to provide specific training in areas NASD deems appropriate).
- 12 Similarly, the National Futures Association (NFA) is requiring continuing education for its existing registrants.
- 13 Some of these qualification exams are NYSE examinations. NASD, NYSE, and other SROs are working collectively to revise qualification examinations to address security futures.
- 14 In contrast, persons registered in all of the other effected categories who intend to engage in a security futures business shall be able to elect to take firm-element continuing education programs until December 31, 2006, even if new qualifying examinations have been created prior to that date.

- 15 For example, the CFMA establishes that margin requirements for security futures be consistent with comparable option contracts and that listing standards for security futures be no less restrictive than comparable listing standards for options traded on a national securities exchange or a national securities association. See Exchange Act Sections 7(c)(2) & 6(h)(3)(C); 15 U.S.C. 78g(c)(2) & 78f(h)(3)(C).
- 16 On September 27, 2001, the SEC published a group of new NFA rules and amendments to NFA rules governing security futures. See 66 FR 49439 (September 27, 2001). The NFA's rules also were modeled after NASD's options rule. In developing NASD's security futures rule, we have sought to adopt requirements that are consistent with those of the NFA to avoid regulatory disparity between firms subject to the jurisdiction of the NFA and NASD.
- 17 The security futures risk disclosure statement has been developed collectively by NASD, NFA, the New York Stock Exchange, the American Stock Exchange, One Chicago, the Chicago Board Options Exchange, NQLX, and the Options Clearing Corporation.
- 18 See NASD Rule 2860(b)(19). We also are amending Interpretive Material 2310-2 (Fair Dealing with Customers) to require members to comply with the security futures sales practices and procedures contained in new Rule 2865.
- 19 See NFA Rule 2-30(j)(4).
- 20 See Exchange Act Release No. 46471 (Sept. 6, 2002), 67 FR 58302 (Sept. 13, 2002).
- 21 See Rule 2860(b)(17).
- 22 See Rule 2860(b)(8).
- 23 National Futures Association Manual, ¶ 9041 (Vol. 7, No. 2 2001).
- 24 Members also are advised that Rule 2240 ("Disclosure of Control Relationship with an Issuer") does not apply to security futures. Rule 2240 requires members that are controlled by, controlling, or under common control with, the issuer of any security to disclose to customers the existence of such control prior to entering into any contract with or for a customer for the purchase or sale of such security.
- 25 See Rule 2210(b)(1) & (c)(2). Although many of the advertising requirements for security futures are similar to the options advertising requirements, the definitions of "options advertisement," "educational material," and "sales literature" differ from the definitions that will apply to security futures. Because the security futures advertising requirements follow the requirements of the NASD's general advertising rule, the definition of "advertisement" is essentially material that is disseminated via mass media channels. See Rule 2210(a)(1). "Sales literature" is defined to include circulars, research reports, market letters, performance reports or summaries, form letters, telemarketing scripts, seminar texts, and reprints or excerpts of any other advertisement, sales literature, or published article that is distributed or made generally available to customers or the public. See Rule 2210(a)(2).
- 26 Rule 2210(d)(1)(A).
- 27 Rule 2210(d)(1)(B).
- 28 Rule 2210(d)(1)(B).
- 29 Rule 2210(d)(1)(A).
- 30 Rule 2210(d)(2)(C).
- 31 Rule 2210(d)(2)(B)(i)a & b.
- 32 These guidelines are similar in many respects to the requirements of Rule 2220, which governs the advertising of options.
- 33 See NFA Rule 2-29(j)(12); see also 66 FR 49439 (September 27, 2001).
- 34 See Rule 2210(d)(1)(B).
- 35 See Rule 2220(d)(2)(A)(i) & (ii), 2220(d)(2)(D)(i).
- 36 Rule 3010(b)(2)(iii).
- 37 NFA Rule 2-9: Enhanced Supervisory Requirements – Interpretive Notice.
- 38 66 FR 45137 (August 27, 2001).
- 39 For NASDAQ National Market securities, NASD rules include an additional short sale restriction: the bid test. See Rule 3350(a). We believe that the bid test has no application to security futures, and we are not proposing any amendments to Rule 3350.

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- 40 See Exchange Act Section 10(a)(2) (15 U.S.C. 78j(a)(2)) (exempting transactions in security futures from short sale provisions in Exchange Act Section 10(a)(1)).
- 41 Currently, the affirmative determination requirement of Rule 3370 does not apply to options transactions.
- 42 See Rule 3370(b)(5)(iv).
- 43 See *Notice to Members 01-22* (April 2001).
- 44 See SEC Interpretation: Commission Guidance on the Application of Certain Provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and Rules thereunder to Trading in Security Futures Products, Release Nos. 33-8107 & 34-46101 (June 27, 2002) (questions 21-23).
- 45 A member is required to file an application pursuant to NASD Rule 1017 for, among other things, a material change in business operations. NASD Rule 1017(e).
- 46 NASD Rule 1011(i).
- 47 See *Notice to Members 00-73* (Oct. 2000).
- 48 *Id.*
- 48 See *Notice to Members 02-39* (July 2002).
- 50 Exchange Act Section 3(a)(11) (15 U.S.C. 78c(a)(11)).

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## ATTACHMENT A

### 1000. Membership, Registration and Qualification Requirements

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### 1020. Registration of Principals

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### 1022. Categories of Principal Registration

(a) through (e) No change

#### (f) Registered Options and Security Futures Principals

(1) Every member of the Association [which] that is engaged in, or [which] that intends to engage in transactions in security futures or put or call options with the public shall have at least one Registered Options and Security Futures Principal who shall have satisfied the requirements of this subparagraph. As to options transactions, each [such] member shall also designate a Senior Registered Options Principal and a Compliance Registered Options Principal in accordance with the provisions of Rule 2860(b)(20) and identify such persons to the Association. [A member which has a Registered Options Principal qualified in either put or call options shall not engage in both put and call option transactions until such time as it has a Registered Options Principal qualified in both such options.] Every person engaged in the management of the day-to-day options or security futures activities of a member shall also be registered as a Registered Options and Security Futures Principal. [In the event any Registered Options Principal ceases to act in such capacity, such fact shall be reported promptly to the Association together with a brief statement of the reasons therefor.]

(2) Each person required by subparagraph (f)(1) [hereof] to be a Registered Options and Security Futures Principal shall pass the appropriate Qualification Examination for Registered Options and Security Futures Principal, or an equivalent examination acceptable to the Association [Corporation], for the purpose of demonstrating an adequate knowledge of options and Security Futures trading generally, the Rules of the Association applicable to trading of option and Security Futures contracts and the rules of registered clearing agencies for options and Security Futures [the Options Clearing Corporation], and be registered as such before engaging

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in the duties or accepting the responsibilities of a Registered Options and Security Futures Principal.

(3) A person shall not qualify as a Registered Options Principal for both put and call options unless he has passed an examination testing him with respect to both put and call options.]

~~(3)~~(4) Each person required to register and qualify as a Registered Options and Security Futures Principal must, prior to or concurrent with such registration, be or become qualified pursuant to the Rule 1030 Series, as either a General Securities Representative or a Limited Representative—Corporate Securities and [also be or become qualified pursuant to Rule 1032(d) as] a Registered Options and Security Futures Representative.

~~(4)~~(5) A person registered solely as a Registered Options and Security Futures Principal shall not be qualified to function in a principal capacity with responsibility over any area of business activity not prescribed in subparagraph (1) [hereof].

~~(5)~~(6) Any person who is registered with NASD as a Registered Options and Security Futures Principal, or who becomes registered as a Registered Options and Security Futures Principal before a revised examination that includes security futures products is offered, must complete a firm-element continuing education program that addresses security futures and a principal's responsibilities for security futures before such person can supervise security futures activities. After a revised examination that includes security futures products is offered, a person associated with a member who passes such a revised Qualification Examination for Registered Options and Security Futures Principal (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program that addresses security futures and a principal's responsibilities for security futures to supervise activities in such products, except as otherwise required by Rule 1120 generally or by the member firm. Any Registered Options and Securities Futures Principal who intends to qualify to supervise security futures activities by completing a firm-element continuing education program must complete such a program by December 31, 2006. Any Registered Options and Securities Futures Principal who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination covering security futures to supervise security futures activities.

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**(g) Limited Principal—General Securities Sales Supervisor**

(1) through (2) No change

(3) Any person who is registered with NASD as a Limited Principal—General Securities Sales Supervisor , or who becomes registered as a Limited Principal – General Securities Sales Supervisor before a revised examination that includes security futures products is offered, must complete a firm-element continuing education program that addresses security futures and a principal’s responsibilities for security futures before such person can supervise security futures activities. After a revised examination that includes security futures products is offered, a person associated with a member who passes such a revised Qualification Examination for Limited Principal—General Securities Sales Supervisor (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program that addresses security futures and a principal’s responsibilities for security futures to supervise such products, except as otherwise required by Rule 1120 generally or by the member firm. Any Limited Principal—General Securities Sales Supervisor who intends to qualify to supervise security futures activities by completing a firm-element continuing education program must complete such a program by December 31, 2006. Any Limited Principal—General Security Sales Supervisor who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination covering security futures to supervise security futures activities.

**IM-1022-1. Registered Options and Security Futures Principals**

Members having a single Registered Options and Security Futures Principal are required promptly to notify the Association in the event such person is terminated, resigns, becomes incapacitated or is otherwise unable to perform the duties of an Options and Security Futures Principal.

Following receipt of such notification, the Association will require members to agree, in writing, to refrain from engaging in any options- or security futures-related activities [which] that would necessitate the prior or subsequent approval of an Options and Security Futures Principal including, among other things, the opening of new options or security futures accounts or the execution of discretionary orders for option or security futures contracts until such time as a new Registered Options and Security Futures Principal has been qualified.

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Members failing to qualify a new Registered Options and Security Futures Principal within two weeks following the loss of their sole Registered Options and Security Futures Principal, or by the earliest available date for administration of the [Series 4] Registered Options and Security Futures Principal examination, whichever is longer, shall be required to cease doing an options and security futures business; provided, however, they may effect closing transactions in options and offsetting transactions in security futures [in order] to reduce or eliminate existing open options or security futures positions in their own account as well as the accounts of their customers.

**IM-1022-2. Limited Principal—General Securities Sales Supervisor**

Limited Principal—General Securities Sales Supervisor is an alternate category of registration designed to lessen the qualification burdens on principals of general securities firms who supervise sales. Without this category of limited registration, such principals could be required to separately qualify pursuant to the rules of the NASD, MSRB, NYSE and the options exchanges. While persons may continue to separately qualify with all relevant self-regulatory organizations, the Limited Principal—General Securities Sales Supervisor Examination permits qualification as a supervisor of sales of all securities by one examination. Persons registered as Limited Principals—General Securities Sales Supervisor may also qualify in any other category of principal registration. Persons who are already qualified in one or more categories of principal registration may supervise sales activities of all securities by also qualifying as Limited Principals—General Securities Sales Supervisor.

Functions that may be performed by Limited Principals—General Securities Sales Supervisors. Any person required to be registered as a principal who supervises sales activities in corporate, municipal and option securities, investment company products, variable contracts, [and] direct participation programs, and security futures may be registered solely as a Limited Principal—General Securities [Sale] Sales Supervisor. In addition to branch office managers, other persons such as regional and national sales managers may also be registered solely as Limited Principals—General Securities Sales Supervisor as long as they supervise only sales activities. Qualification as a General Securities Representative is a prerequisite for registration as a Limited Principal—General Securities Sales Supervisor.

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## 1032. Categories of Representative Registration

### (a) General Securities Representative

- (1) No change
- (2) Except as provided in Rule 1031(c):
  - (A) through (D) No change

(E) A person who is registered with the Association as a General Securities Representative, or who becomes registered as a General Securities Representative before a new examination that includes security futures is offered, must complete a firm-element continuing education program that addresses security futures products. After a new examination that includes security futures products is offered, a person associated with a member who passes such a new Qualification Examination for General Securities Representative (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program that addresses security futures to act as a General Securities Representative with regard to such products, except as otherwise required by Rule 1120 generally or by the member firm. Once the new examination that includes security futures becomes available, persons seeking to become a General Securities Representative will be required to pass such new examination (or any other examination covering security futures that is acceptable to NASD) to act as a General Securities Representative with regard to security futures products. Only persons registered as a General Securities Representative prior to the time that the new examination is available ("eligible General Securities Representatives") will be eligible to use a firm-element continuing education program in lieu of passing the new examination or module to engage in a security futures business. Any eligible General Securities Representative who intends to qualify as a General Securities Representative with regard to security futures products by completing a firm-element continuing education program must complete such a program by December 31, 2006. Any eligible General Securities Representative who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination to engage in security futures activities.

(E) through (H) Renumbered as (F) through (I)

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(3) A person registered as a General Securities Representative shall not be qualified to function as a Registered Options and Security Futures Representative unless he or she is also qualified and registered as such pursuant to the provisions of paragraph (d) [hereof].

(b) through (c) No change

**(d) Limited Representative—Options and Security Futures**

(1) Each person associated with a member who is included within the definition of a representative as defined in Rule 1031 may register with the Association as a Limited Representative—Options and Security Futures if:

(A) such person's activities in the investment banking or securities business of the member involve the solicitation or sale of option or security futures contracts, including option contracts on government securities as that term is defined in Section 3(a)(42)(D) of the Act, for the account of a broker, dealer or public customer; and

(B) such person passes an appropriate qualification examination for Limited Representative—Options and Security Futures.

(2) Each person seeking to register and qualify as a Limited Representative—Options and Security Futures must, concurrent with or before such registration may become effective, become registered pursuant to the Rule 1032 Series, either as a Limited Representative—Corporate Securities or Limited Representative—Government Securities.

(3) A person registered as a Limited Representative—Options and Security Futures shall not be qualified to function in any area not described in subparagraph (1)(A) [hereof].

(4) Any person who is registered with the Association as a Limited Representative—Options and Security Futures, or who becomes registered as a Limited Representative—Options and Security Futures before a revised examination that includes security futures is offered, must complete a firm-element continuing education program that addresses security futures. After a revised examination that includes security futures products is offered, a person associated with a member who passes such a revised Qualification Examination for Limited Representative—Options and Security Futures (or any other examination covering security futures that is acceptable to NASD) is not required to complete a firm-element continuing education program that addresses security futures to act as a limited representative with regard to such products, except as otherwise required by Rule 1120 generally or by the member firm. Any Limited Representative—Options and Security Futures who intends to qualify as a Limited Representative with regard to security futures products by completing a firm-element

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continuing education program must complete such a program by December 31, 2006. Any Limited Representative—Options and Security Futures who has not completed a firm-element continuing education program by that date will be required to pass an appropriate qualification examination covering security futures to engage in security futures activities.

(e) through (h) No change

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### **1060. Persons Exempt from Registration**

(a) The following persons associated with a member are not required to be registered with the Association:

(1) through (3) No Change

(4) persons associated with a member whose functions are related solely and exclusively to:

(A) No Change

(B) transactions in municipal securities; [or]

(C) transactions in commodities; or

(D) transactions in security futures, provided that any such person is registered with a registered futures association.

(b) No Change

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### **IM-2110-3. Front Running Policy**

It shall be considered conduct inconsistent with just and equitable principles of trade for a member or person associated with a member, for an account in which such member or person associated with a member has an interest, for an account with respect to which such member or person associated with a member exercises investment discretion, or for certain customer accounts, to cause to be executed:

(a) an order to buy or sell an option or a security future when such member or person associated with a member causing such order to be executed has material, non-public market information concerning an imminent block transaction in the underlying security, or when a

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customer has been provided such material, non-public market information by the member or any person associated with a member; or

(b) an order to buy or sell an underlying security when such member or person associated with a member causing such order to be executed has material, non-public market information concerning an imminent block transaction in an option or a security future overlying that security, or when a customer has been provided such material, non-public market information by the member or any person associated with a member; prior to the time information concerning the block transaction has been made publicly available.

The violative practice noted above may include transactions which are executed based upon knowledge of less than all of the terms of the block transaction, so long as there is knowledge that all of the material terms of the transaction have been or will be agreed upon imminently.

The general prohibitions stated above shall not apply to transactions executed by member participants in automatic execution systems in those instances where participants must accept automatic executions.

These prohibitions also do not include situations in which a member or person associated with a member receives a customer's order of block size relating to both an option and the underlying security or both a security future and the underlying security. In such cases, the member and person associated with a member may position the other side of one or both components of the order. However, in these instances, the member and person associated with a member would not be able to cover any resulting proprietary position(s) by entering an offsetting order until information concerning the block transaction involved has been made publicly available.

The application of this front running policy is limited to transactions that are required to be reported on the last sale reporting systems administered by Nasdaq, Consolidated Tape Association (CTA), or Option Price Reporting Authority (OPRA). The front running policy also applies to security futures transactions regardless of whether such products are reported pursuant to such systems. Information as to a block transaction shall be considered to be publicly available when it has been disseminated via the tape or high speed communications line of one of those systems, a similar system of a national securities exchange under Section 6 of the Act, an alternative trading system under Regulation ATS, or by [of] a third-party news wire service.

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A transaction involving 10,000 shares or more of an underlying security, or options or security futures covering such number of shares is generally deemed to be a block transaction, although a transaction of less than 10,000 shares could be considered a block transaction in appropriate cases. A block transaction that has been agreed upon does not lose its identity as such by arranging for partial executions of the full transaction in portions which themselves are not of block size if the execution of the full transaction may have a material impact on the market. In this situation, the requirement that information concerning the block transaction be made publicly available will not be satisfied until the entire block transaction has been completed and publicly reported.

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#### **2210. Communications with the Public**

(a) No change

(b) Approval and Recordkeeping

(1) Each item of advertising and sales literature shall be approved by signature or initial, prior to use or filing with [the Association] NASD, by a registered principal of the member. This requirement may be met, only with respect to corporate debt and equity securities that are the subject of research reports as the term is defined in Rule 472 of the New York Stock Exchange, by the signature or initial of a supervisory analyst approved pursuant to Rule 344 of the New York Stock Exchange. This requirement may be met, only with respect to advertising and sales literature concerning security futures, by the signature or initial of a principal qualified to supervise security futures activities.

(2) No Change

(c) Filing Requirements and Review Procedures

(1) No change

(2) Advertisements concerning collateralized mortgage obligations, advertisements concerning security futures, and advertisements and sales literature concerning registered investment companies (including mutual funds, variable contracts and unit investment trusts) that include or incorporate rankings or comparisons of the investment company with other investment companies where the ranking or comparison category is not generally published or is the creation, either directly or indirectly, of the investment company, its underwriter or an affiliate, shall be filed with the Department for review at least 10 days

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prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changed by the Association, shall be withheld from publication or circulation until any changes specified by the Association have been made or, if expressly disapproved, until the advertisement has been refiled for, and has received, Association approval. The member must provide with each filing the actual or anticipated date of first use. Any member filing any investment company advertisement or sales literature pursuant to this paragraph shall include a copy of the data, ranking or comparison on which the ranking or comparison is based.

(3) through (9) No Change

**(d) Standards Applicable to Communications with the Public**

(1) No Change

**(2) Specific Standards**

In addition to the foregoing general standards, the following specific standards apply:

(A) No Change

**(B) Recommendations**

(i) In making a recommendation in advertisements and sales literature, whether or not labeled as such, a member must have a reasonable basis for the recommendation and must disclose any of the following situations which are applicable:

a. that the member usually makes a market in the securities being recommended, or in the underlying security if the recommended security is an option or security future, or that the member or associated persons will sell to or buy from customers on a principal basis;

b. that the member and/or its officers or partners own options, security futures, rights or warrants to purchase any of the securities of the issuer whose securities are recommended, unless the extent of such ownership is nominal;

c. No Change

(ii) through (iv) No Change

(e) through (f) No Change

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## **IM-2210-7. Guidelines for Communications with the Public Regarding Security Futures**

### **(a) Association Approval Requirements and Review Procedures**

(1) As set forth in paragraph (c)(2) of Rule 2210, all advertisements concerning security futures shall be submitted to the Advertising/Investment Companies Regulation Department of the Association at least ten days prior to use for approval and, if changed by the Association, shall be withheld from circulation until any changes specified by the Association have been made or, in the event of disapproval, until the advertisement has been refiled for, and has received, Association approval.

(2) The requirements of this paragraph (a) shall not be applicable to:

(A) advertisements submitted to another self-regulatory organization having comparable standards pertaining to such advertisements, and

(B) advertisements in which the only reference to security futures is contained in a listing of the services of a member organization.

### **(b) Disclosure Statement**

(1) All communications concerning security futures shall be accompanied or preceded by the security futures risk disclosure statement unless they meet the following requirements:

(A) Such communications shall be limited to general descriptions of the security futures being offered.

(B) Such communications shall contain contact information for obtaining a copy of the security futures risk disclosure statement.

(C) Such communications shall not contain recommendations or past or projected performance figures, including annualized rates of return.

(2) Communications concerning security futures that meet the requirements of subparagraph (1) may have the following characteristics:

(A) the text of the communication may contain a brief description of security futures, including a statement that identifies registered clearing agencies for security futures. The text may also contain a brief description of the general attributes and method of operation of the security exchange or notice-registered securities exchange on which such security futures are traded, including a discussion of how a security

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future is priced;

(B) the communication may include any statement required by any state law or administrative authority; and

(C) advertising designs and devices, including borders, scrolls, arrows, pointers, multiple and combined logos and unusual type faces and lettering as well as attention-getting headlines and photographs and other graphics may be used, provided such material is not misleading.

**(c) Recordkeeping**

Consistent with paragraph (b)(2) of Rule 2210, a member shall keep a separate file of all advertisements and sales literature concerning security futures, including the name(s) of the person(s) who prepared them and approved their use for a period of three years from the date of each use. In addition, members shall meet the same recordkeeping requirements for all correspondence concerning security futures. In the case of sales literature concerning security futures, a member shall record the source of any recommendation contained therein.

**(d) Specific Standards**

(1) The special risks attendant to security futures transactions and the complexities of certain security futures investment strategies shall be reflected in any communications that discuss the uses or advantages of security futures. Any statement referring to the potential opportunities or advantages presented by security futures shall be balanced by a statement of the corresponding risks. The risk statement shall reflect the same degree of specificity as the statement of opportunities, and broad generalities should be avoided.

(2) Security futures communications shall include a warning to the effect that security futures are not suitable for all investors and such communications shall not contain suggestions to the contrary.

(3) Security futures communications shall state that supporting documentation for any claims (including any claims made on behalf of security futures programs or the security futures expertise of sales persons), comparisons, recommendations, statistics or other technical data, will be supplied upon request.

(4) No cautionary statements or caveats, often called hedge clauses, may be used in communications with the public if they are not legible, are misleading, or are inconsistent with the content of the material.

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(5) Statements suggesting the certain availability of a secondary market for security futures shall not be made.

**(e) Projections**

Notwithstanding the provisions of Rule 2210(d)(2)(N), security futures sales literature and correspondence may contain projected performance figures (including projected annualized rates of return), provided that:

(1) all such sales literature and correspondence must be accompanied or preceded by the security futures risk disclosure statement;

(2) no suggestion of certainty of future performance is made;

(3) parameters relating to such performance figures are clearly established;

(4) all relevant costs, including commissions, fees, and interest charges (as applicable) are disclosed and reflected in the projections;

(5) such projections are plausible and are intended as a source of reference or a comparative device to be used in the development of a recommendation;

(6) all material assumptions made in such calculations are clearly identified;

(7) the risks involved in the proposed transactions are also disclosed; and

(8) in communications relating to annualized rates of return, that such returns are not based upon any less than a sixty-day experience; any formulas used in making calculations are clearly displayed; and a statement is included to the effect that the annualized returns cited might be achieved only if the parameters described can be duplicated and that there is no certainty of doing so.

**(f) Historical Performance**

Security futures sales literature and correspondence may feature records and statistics that portray the performance of past recommendations or of actual transactions, provided that:

(1) all such sales literature and correspondence must be accompanied or preceded by the security futures risk disclosure statement;

(2) any such portrayal is done in a balanced manner, and consists of records or statistics that are confined to a specific "universe" that can be fully isolated and circumscribed and that covers at least the most recent 12-month period;

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(3) such communications include the date of each initial recommendation or transaction, the price of each such recommendation or transaction as of such date, and the date and price of each recommendation or transaction at the end of the period or when liquidation was suggested or effected, whichever was earlier; provided that if the communications are limited to summarized or averaged records or statistics, in lieu of the complete record there may be included the number of items recommended or transacted, the number that advanced and the number that declined, together with an offer to provide the complete record upon request;

(4) such communications disclose all relevant costs, including commissions, fees, and daily margin obligations (as applicable);

(5) whenever such communications contain annualized rates of return, such communications shall disclose all material assumptions used in the process of annualization;

(6) an indication is provided of the general market conditions during the period(s) covered, and any comparison made between such records and statistics and the overall market (e.g., comparison to an index) is valid;

(7) such communications state that the results presented should not and cannot be viewed as an indicator of future performance; and

(8) a principal qualified to supervise security futures activities determines that the records or statistics fairly present the status of the recommendations or transactions reported upon and so initials the report.

**(g) Security Futures Programs**

In communications regarding a security futures program (i.e., an investment plan employing the systematic use of one or more security futures strategies), the cumulative history or unproven nature of the program and its underlying assumptions shall be disclosed.

**(h) Standard Forms of Worksheets**

Such worksheets must be uniform within a member firm. If a member has adopted a standard form of worksheet for a particular security futures strategy, nonstandard worksheets for that strategy may not be used.

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**(i) Recordkeeping**

Communications that portray performance of past recommendations or actual transactions and completed worksheets shall be kept at a place easily accessible to the sales office for the accounts or customers involved.

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**IM-2310-2. Fair Dealing with Customers**

(a) through (d) No change

**(e) Fair Dealing with Customers with Regard to Derivative Products or New Financial Products**

The Board emphasizes members' obligations for fair dealing with customers when making recommendations or accepting orders for new financial products. As new products are introduced from time to time, it is important that members make every effort to familiarize themselves with each customer's financial situation, trading experience, and ability to meet the risks involved with such products and to make every effort to make customers aware of the pertinent information regarding the products. Members must follow specific guidelines, set forth below, for qualifying the accounts to trade the products and for supervising the accounts thereafter.

**(1) Security Futures**

Members must comply with the Rules, regulations and procedures applicable to security futures contained in Rule 2865.

**(2) Index Warrants**

Members are obliged to comply with the Rules, regulations and procedures applicable to index warrants and foreign currency warrants contained in the Rule 2840 Series.

**[(2)] (3) Hybrid Securities and Selected Equity-Linked Debt Securities ("SEEDS") Designated as Nasdaq National Market Securities Pursuant to the Rule 4400 Series**

Members are obligated to comply with any Rules, regulations, or procedures applicable to such securities pursuant to the Rule 4420 Series, as well as any other applicable Rule, regulation, or procedure of the Association.

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## **2865. Security Futures**

(a) For purposes of this Rule, the term “security future” shall have the definition specified in Section 3(a)(55) of the Act.

### **(b) Requirements**

#### **(1) General**

(A) Applicability—This Rule shall be applicable to the trading of security futures.

(B) Paragraphs (12) and (15) shall apply only to security futures carried in securities accounts.

(C) Except to the extent that specific provisions in this Rule govern, or unless the context otherwise requires, the provisions of the By-Laws and Rules and all other interpretations and policies of the Board of Governors shall also be applicable to the trading of security futures.

#### **(2) Definitions**

(A) The terms “Beneficial Owner,” “Control,” and “Controls,” “Is Controlled by” or “Is Under Common Control With” shall have the same meanings as in Rule 2860.

(B) The term “principal qualified to supervise security futures activities” means a Registered Options and Security Futures Principal who, consistent with Rule 1022, has either completed a firm-element continuing education requirement that addresses security futures and a principal’s responsibilities for security futures or has passed a revised qualification examination for Registered Options and Security Futures Principals that covers security futures, or a Limited Principal—General Securities Sales Supervisor who, consistent with Rule 1022, has either completed a firm-element continuing education requirement that addresses security futures and a principal’s responsibilities for security futures or has passed a revised qualification examination for Limited Principal—General Securities Sales Supervisor.

(3) through (7) Reserved

#### **(8) Restrictions on Security Futures Transactions**

The Association may impose from time to time such restrictions on security futures transactions that it determines are necessary in the interest of maintaining a fair and orderly market in security futures, or in the underlying securities covered by such security

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futures, or otherwise necessary in the public interest or for the protection of investors. During the period of any such restriction, no member shall effect any security futures transaction in contravention of such restriction.

(9) through (10) Reserved

**(11) Delivery of Security Futures Risk Disclosure Statement**

(A) Every member shall deliver the current security futures risk disclosure statement to each customer at or prior to the time such customer's account is approved for trading security futures. Thereafter, each new or revised security futures risk disclosure statement shall be distributed to every customer having an account approved for such trading or, in the alternative, shall be distributed not later than the time a confirmation of a transaction is delivered to each customer who enters into a security futures transaction. The Association will advise members when a new or revised current security futures risk disclosure statement is available.

(B) Where a broker or dealer enters its orders with another member in a single omnibus account, the member holding the account shall take reasonable steps to assure that such broker or dealer is furnished reasonable quantities of the current security futures risk disclosure statement.

(C) Where an introducing broker or dealer enters orders for its customers with, or clears transactions through, a member on a fully disclosed basis and that member carries the accounts of such customers, the responsibility for delivering the current security futures risk disclosure statement as provided in this paragraph (b)(11) shall rest with the member carrying the accounts. However, such member may rely upon the good faith representation of the introducing broker or dealer that the current security futures risk disclosure statement has been delivered in compliance with paragraph (b)(11).

(12) Reserved

(13) Reserved

(14) Reserved

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### **(15) Statements of Account**

Statements of account showing security and money positions, entries, interest charges, and any special charges that have been assessed against such account during the period covered by the statement shall be sent no less frequently than once every month to each customer in whose account there has been an entry during the preceding month with respect to a security futures contract and quarterly to all customers having an open security futures position or money balance. Interest charges and any special charges assessed during the period covered by the statement need not be specifically delineated if they are otherwise accounted for on the statement and have been itemized on transaction confirmations. With respect to security futures customers having a general (margin) account, such statements shall also provide the market price, and mark-to-market value and nominal value of each security futures position and other security positions in the general (margin) account (i.e., the mark-to-market value of all security futures positions and the market value of all other security positions), the total value of all positions in the account, the outstanding debit or credit balance in the account, and the general (margin) account equity. The statements shall bear a legend stating that further information with respect to commissions and other charges related to the execution of security futures transactions has been included in confirmations of such transactions previously furnished to the customer, and that such information will be made available to the customer promptly upon request. The statements shall also bear a legend requesting the customer promptly to advise the member of any material change in the customer's investment objectives or financial situation.

### **(16) Opening of Accounts**

#### **(A) Approval Required**

No member or person associated with a member shall accept an order from a customer to purchase or sell a security future, or approve the customer's account for the trading of security futures, unless the broker or dealer furnishes or has furnished to the customer the appropriate security futures risk disclosure statement and the customer's account has been approved for security futures trading in accordance with the provisions of subparagraphs (B) through (D) hereof.

#### **(B) Diligence in Opening Accounts**

In approving a customer's account for security futures trading, a member or any person associated with a member shall exercise due diligence to ascertain the essential

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facts relative to the customer, the customer's financial situation and investment objectives. Members shall establish specific minimum net equity requirements for initial approval and maintenance of customers' security futures accounts. Based upon such information, a principal qualified to supervise security futures activities shall specifically approve or disapprove in writing the customer's account for security futures trading. For account approvals, the written record shall include the reasons for approval.

(i) With respect to security futures customers who are natural persons, members shall seek to obtain the following information at a minimum (information shall be obtained for all participants in a joint account):

a. Investment objectives (e.g., safety of principal, income, growth, trading profits, or speculation);

b. Employment status (name of employer, self-employed, or retired);

c. Estimated annual income from all sources;

d. Estimated net worth (exclusive of family residence);

e. Estimated liquid net worth (cash, securities, or other);

f. Marital status and number of dependents;

g. Age; and,

h. Investment experience and knowledge (e.g., number of years, size, frequency and type of transactions) for futures, commodities, options, stocks, bonds, and other financial instruments.

(ii) In addition, a customer's account records shall contain the following information, if applicable:

a. Source or sources of background and financial information (including estimates) concerning the customer;

b. Discretionary authorization agreement on file, name, relationship to customer, and experience of person holding trading authority;

c. Date disclosure document(s) furnished to customer;

d. Name of registered representative;

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e. Name of principal approving account and date of approval; and

f. Dates of verification of currency of account information.

(iii) Members should consider using a standard account approval form to ensure the receipt of all the required information.

(iv) Refusal of a customer to provide any of the information specified in subparagraph (i) shall be so noted on the customer's records at the time the account is opened. Information provided shall be considered together with the other information available in determining whether to approve the account for security futures trading.

(v) A record of the information obtained pursuant to this subparagraph (B) and of the approval or disapproval of each account shall be maintained by the member as part of its records in accordance with paragraph (b)(17) herein.

#### **(C) Verification of Customer Background and Financial Information**

For every natural person whose account has been approved for security futures trading, the background and financial information upon which the account was approved shall be sent to the customer for verification within fifteen (15) days after the customer's account has been approved for security futures trading. This verification requirement shall not apply if the background and financial information is included in the customer's account agreement or if the member has previously verified the customer's information in connection with an options account. A copy of the background and financial information on file with a member also shall be sent to the customer for verification within fifteen (15) days after the member becomes aware of any material change in the customer's financial situation.

Members shall satisfy the initial and subsequent verification of customer background and financial information by sending to the customer the information required in paragraph (B)(i)(a) through (i)(f) hereof, as contained in the member's records and providing the customer with an opportunity to correct or complete the information. In all cases, absent advice from the customer to the contrary, the information will be deemed to be verified.

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#### **(D) Account Agreement**

Within fifteen (15) days after a customer's account has been approved for security futures trading, a member shall obtain from the customer a written agreement that the customer is aware of and agrees to be bound by the Rules of the Association applicable to the trading of security futures and, that the customer has received a copy of the current security futures risk disclosure statement. In addition, the customer should indicate on such written agreement that the customer is aware of and agrees not to violate applicable security futures position limits.

#### **(17) Maintenance of Records**

(A) In addition to the requirements of Rule 3110, every member shall maintain and keep current a separate central log, index, or other file for all security futures-related complaints, through which these complaints can easily be identified and retrieved. The central file shall be located at the principal place of business of the member or such other principal office as shall be designated by the member. At a minimum, the central file shall include: (i) identification of complainant; (ii) date complaint was received; (iii) identification of registered representative servicing the account; (iv) a general description of the matter complained of; and (v) a record of what action, if any, has been taken by the member with respect to the complaint. For purposes of this subparagraph, the term "security futures-related complaint" shall mean any written statement by a customer or person acting on behalf of a customer alleging a grievance arising out of or in connection with security futures. Each security futures-related complaint received by a branch office of a member shall be forwarded to the office in which the separate, central file is located not later than 30 days after receipt by the branch office that is the subject of the complaint. A copy of every security futures-related complaint shall also be maintained at the branch office that is the subject of the complaint.

(B) Background and financial information of customers who have been approved for security futures trading shall be maintained at both the branch office servicing the customer's account and the principal supervisory office having jurisdiction over that branch office. Copies of account statements of security futures customers shall also be maintained at both the branch office supervising the accounts and the principal supervisory office having jurisdiction over that branch for the most recent six-month period. With respect solely to the above-noted record retention requirements applicable to principal supervisory offices, however, the customer information and

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account statements may be maintained at a location other than the principal supervisory office if such documents and information are readily accessible and promptly retrievable. Other records necessary to the proper supervision of accounts shall be maintained at a place easily accessible both to the branch office servicing the customer's account and to the principal supervisory office having jurisdiction over that branch office.

### **(18) Discretionary Accounts**

#### **(A) Authorization and Approval**

(i) No member or person associated with a member shall exercise any discretionary power with respect to trading in security futures in a customer's account, or accept orders for security futures for an account from a person other than the customer, except in compliance with the provisions of Rule 2510 and unless:

a. The written authorization of the customer required by Rule 2510 shall specifically authorize security futures trading in the account; and

b. the account shall have been accepted in writing by a principal qualified to supervise security futures activities.

(ii) When analyzing an account to determine if it should be approved for security futures trading, a principal qualified to supervise security futures activities shall have a reasonable basis for believing that the customer was able to understand and bear the risk of the strategies or transactions proposed, and shall maintain a record of the basis for such determination. Each discretionary order shall be approved and initialed on the day entered by the branch office manager or other principal qualified to supervise security futures activities, provided that if the branch officer is not a principal qualified to supervise security futures activities, such approval shall be confirmed within a reasonable time by a principal qualified to supervise security futures activities. Each discretionary order shall be identified as discretionary on the order at the time of entry. Discretionary accounts shall receive frequent appropriate supervisory review. The provisions of this subparagraph (18) shall not apply to discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite number of security futures contracts in a specified security shall be executed.

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**(B) Record of Transactions**

A record shall be made of every transaction in security futures contracts in respect to which a member or person has exercised discretionary authority, clearly reflecting such fact and indicating the name of the customer, the designation and number of the security futures contracts, the price of the contract, and the date and time when such transaction was effected.

**(C) Security Futures Programs**

Where the discretionary account uses security futures programs involving the systematic use of one or more security futures strategies, the customer shall be furnished with a written explanation of the nature and risks of such programs.

**(19) Suitability**

(A) No member or person associated with a member shall recommend to any customer any transaction or trading strategy for the purchase or sale of a security future unless such member or person associated with the member has reasonable grounds to believe upon the basis of information furnished by the customer after reasonable inquiry by the member or person associated with the member concerning the customer's investment objectives, financial situation and needs, and any other information known by the member or associated person, that the recommended transaction or trading strategy is not unsuitable for the customer.

(B) No member or person associated with a member shall recommend to a customer a transaction in any security future unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer has such knowledge and experience in financial matters that the customer may reasonably be expected to be capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended position in the security future.

(20) Reserved

**(21) Violation of By-Laws and Rules of the Association or a Registered Clearing Agency**

(A) In Association disciplinary proceedings, a finding of violation of any provision of the rules, regulations, or by-laws of a registered clearing agency

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under Section 17A(b)(8) of the Act by any member or person associated with a member engaged in security futures transactions cleared by such registered clearing agency, may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110.

(B) In Association disciplinary proceedings, a finding of violation of any provision of the Rules, regulations or By-Laws of the Association by any member or person associated with a member engaged in security futures transactions may be deemed to be conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110.

(22) Reserved

(23) Reserved

(24) Security Futures Transactions and Reports by Market Makers in Listed Securities

Every member that is an off-board market maker in a security listed on a national securities exchange shall report to the Association in accordance with such procedures as may be prescribed by the Board of Governors, transactions involving 50 or more security futures contracts on such listed securities that are either directly for the benefit of (A) the member or (B) any employee, partner, officer, or director of the member who, by virtue of his or her position with the member, is directly involved in the purchase or sale of the underlying security for the firm's proprietary account(s) or is directly responsible for supervision of such persons; or who by virtue of his or her position in the firm, is authorized to, and regularly does, obtain information on the proprietary account(s) of the member in which the underlying security is traded. This subparagraph shall apply to all security futures transactions including those executed on an exchange to which the member may belong.

(25) Trading Ahead of Customer Orders

Every member shall exercise due care to avoid trading ahead of a customer's security futures order. A member must exercise the due care required by this subsection when the member has gained knowledge of or reasonably should have gained knowledge of the customer's order prior to the transmission to a securities exchange of the member's order for a proprietary account, or for any account in which it or any person associated with it is directly or indirectly interested.

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### **3010. Supervision**

(a) No change

#### **(b) Written Procedures**

(1) No Change

#### **(2) Tape recording of conversations**

(i) through (viii) No change

(x) For purposes of this Rule, the term “disciplined firm” means either a member that, in connection with sales practices involving the offer, purchase, or sale of any security, has been expelled from membership or participation in any securities industry self-regulatory organization or is subject to an order of the Securities and Exchange Commission revoking its registration as a broker/dealer; or a futures commission merchant or introducing broker that has been formally charged by either the Commodity Futures Trading Commission or a registered futures association with deceptive telemarketing practices or promotional material relating to security futures, those charges have been resolved, and the futures commission merchant or introducing broker has been closed down and permanently barred from the futures industry as a result of those charges; or a futures commission merchant or introducing broker that, in connection with sales practices involving the offer, purchase, or sale of security futures is subject to an order of the Securities and Exchange Commission revoking its registration as a broker or dealer.

(xi) No change

(c) through (d) No change

#### **(e) Qualifications Investigated**

Each member shall have the responsibility and duty to ascertain by investigation the good character, business repute, qualifications, and experience of any person prior to making such a certification in the application of such person for registration with this Association. Where an applicant for registration has previously been registered with the Association, the member shall review [obtain from the Central Registration Depository or from the applicant] a copy of the Uniform Termination Notice of Securities Industry Registration (Form U-5) filed with the

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Association by such person's most recent previous NASD member employer, together with any amendments thereto that may have been filed pursuant to Article V, Section 3 of the Association's By-Laws. The member shall review [obtain] the Form U-5 as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to the Association that it has made reasonable efforts to comply with the requirement. [A member receiving a Form U-5 pursuant to this Rule shall review] In conducting its review of the Form U-5 and any amendments thereto, a member [and] shall take such action as may be deemed appropriate.

Where an applicant for registration has been previously registered with a registered futures association ("RFA") member that is or has been registered as a broker/dealer pursuant to Section 15(b)(11) of the Act ("notice-registered broker/dealer") with the SEC to trade security futures, the member shall review a copy of the Notice of Termination of Associated Person (Form 8-T) filed with the RFA by such person's most recent previous RFA member employer, together with any amendments thereto. The member shall review the Form 8-T as required by this Rule no later than sixty (60) days following the filing of the application for registration or demonstrate to the Association that it has made reasonable efforts to comply with the requirement. In conducting its review of a Form 8-T and any amendments, a member shall take such action as may be deemed appropriate.

(f) through (g) No change

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### **3050. Transactions for or by Associated Persons**

(a) through (c) No change

#### **(d) Obligations of Associated Persons Concerning an Account with a Notice-Registered Broker/Dealer, Investment Adviser, Bank, or Other Financial Institution**

A person associated with a member who opens a securities account or places an order for the purchase or sale of securities with a broker/dealer that is registered pursuant to Section 15(b)(11) of the Act ("notice-registered broker/dealer"), a domestic or foreign investment adviser, bank, or other financial institution, except a member, shall:

(1) notify his or her employer member in writing, prior to the execution of any initial transactions, of the intention to open the account or place the order; and

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(2) upon written request by the employer member, request in writing and assure that the notice-registered broker/dealer, investment adviser, bank, or other financial institution provides the employer member with duplicate copies of confirmations, statements, or other information concerning the account or order;

provided, however, that if an account subject to this paragraph (d) was established prior to a person's association with a member, the person shall comply with this paragraph promptly after becoming so associated.

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### **3370. Prompt Receipt and Delivery of Securities**

(a) No change

(b) Sales

(1) No change

(2) "Short Sales"

(A) Customer short sales

No member or person associated with a member shall accept a "short" sale order for any customer in any security unless the member or person associated with a member makes an affirmative determination that the member will receive delivery of the security from the customer or that the member can borrow the security on behalf of the customer for delivery by settlement date. This requirement shall not apply, however, to transactions in corporate debt securities or transactions in security futures, as defined in Section 3(a)(55) of the Act.

(B) Proprietary short sales

No member shall effect a "short" sale for its own account in any security unless the member or person associated with a member makes an affirmative determination that the member can borrow the securities or otherwise provide for delivery of the securities by the settlement date. This requirement will not apply to transactions in corporate debt securities, to transactions in security futures, as defined in Section 3(a)(55) of the Act, to bona fide market making transactions by a member in securities in which it is registered as a Nasdaq market maker, to bona fide market maker transactions in non-Nasdaq securities in which the market maker publishes a two-sided

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quotation in an independent quotation medium, or to transactions [which] that result in fully hedged or arbitrated positions.

(3) through (4) No change

**(5) "Bona Fide Fully Hedged" and "Bona Fide Fully Arbitrated"**

In determining the availability of the exemption provided in paragraph (b)(2)(B) above and in Rule 11830 from short sale requirements for "bona fide fully hedged" and "bona fide fully arbitrated" transactions, the following guidelines shall apply. These guidelines are for illustrative purposes and are not intended to limit the Association's ability to determine the proper scope of the terms "bona fide fully hedged" or "bona fide fully arbitrated" pursuant to this provision, on a case-by-case basis.

**(A) Bona Fide Fully Hedged**

The following transactions shall be considered bona fide fully hedged:

(i) through (iii) No change

(iv) Short a security and long a single stock future of the underlying security.

Example: Long 1 single stock future of MNOP.

- With the circumstances as above (and assuming a contract size of 100) 100 shares would be exempt.
- Even if the expiration date for the single stock future was more than 90 calendar days, 100 shares would be exempt.

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## ATTACHMENT B

### NASD Security Futures Information

#### *Security Futures*

The content outline provided below has been established by NASD and NFA for use by firms in developing their firm-element training programs. The outline contains five modules or segments: (1) Stock and Stock Options; (2) Futures Contracts; (3) Security Futures Products; (4) Regulatory Requirements for Security Futures; and (5) Supervision of the Offer and Sale of Security Futures.

Module 1 is intended primarily for futures professionals as an introduction to securities and securities law concepts. NASD will not require broker/dealers to administer the content of Module 1 to securities registrants. Firms should decide on their own whether their employees would benefit from the basic securities overview.

Module 2 is intended primarily for securities professionals as an introduction to the basic concepts and terminology of futures. In general, NASD will require that members administer the content of Module 2 to securities registrants, although firms employing dually-licensed persons (i.e., persons registered with a broker/dealer and an futures commission merchant or introducing broker), may not need to administer Module 2 to such persons.

Module 3 explains the characteristics and elements of security futures. Module 4 describes the regulatory framework, including sales practice and margin requirements, for these new products. All NASD member firms must administer the content of Modules 3 and 4 to their personnel before such persons may engage in a security futures business.

Lastly, Module 5 addresses issues relevant for persons who will be supervising personnel engaged in a security futures business. Firms must administer Module 5 to their appropriately qualified individuals before such persons can supervise security futures activity.

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## Module 1: Stocks and Stock Options

### Introduction to Stocks

- Capital formation
- Shares in Corporate Ownership
- Dividends
- Common Stock
- Preferred Stock
- Restricted Stock
- ADRs
- Corporate Actions
  - Stock splits
  - Reverse stock splits
  - Mergers and takeovers
  - Spin-offs

### Stock and Stock Options Markets and Clearing Organizations

- The Nasdaq Stock Market
- NYSE, AMEX and Regional Stock Exchanges
- Intermarket Trading System
- Electronic Communications Networks
- Options Exchanges
- Options Clearing Corporation
- Product fungibility

### Trading Stocks

- Price quotation conventions
- Short selling
  - Uptick rule
  - Stock loan

- Affirmative determination
- Dividends

Types of orders (different than those in the futures markets)

- All-or-none orders

Immediate-or-cancel orders

Fill-or-kill orders

Trade settlement

Insider trading

Delayed openings

Trading halts

Circuit breakers

### Stock Options and Stock Index Options

Basic description

Synthetics

### Stock Market Analysis and Related Statistical Measures

Stocks by sector Stocks by strategy and Industry outlook

- Growth stocks
- Value stocks
- Income stocks

Stocks by market capitalization

- Large Cap
- Mid Cap
- Small Cap

Statistical measures

- Alpha
- Beta

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### **Corporate Announcements and Other News and Information**

Quarterly earnings reports  
Corporate statements between reports  
Insider filings  
Short interest reports

### **Income Statement and Balance Sheet**

General description  
Earnings per share  
Price/Earnings ratio  
Dividend yield  
Book value  
Liquidity measures

- Current assets
- Quick assets
- Current liabilities
- Working capital
- Current ratio
- Acid-test ratio
- Cash flow

### **Margin for Stocks and Stock Options**

Initial and maintenance margin for stock purchases  
Initial and maintenance margin for short stock positions  
Options margin

- Premium payments
- Margin for short positions

### **Securities Investor Protection Corporation**

Purpose of SIPC  
Coverage limits  
Coverage amounts

## **Module 2: Futures Contracts**

### **Introduction to Futures Contracts**

General characteristics  
Equal treatment of buys and sells  
Standardized contract terms

### **Futures Markets and Clearing Organizations**

Open-outcry  
Electronic trading  
Floor brokers  
Floor traders  
Non-fungibility across exchanges  
Role of clearinghouse

- Matching trades
- Effecting settlement and payments
- Guaranteeing performance
- Facilitating deliveries

### **Trading Futures**

Settlement

- Physical delivery
- Cash settlement

Daily price limits  
Circuit breakers

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Types of orders (different than those in the securities markets)

- Spread orders
- Switch orders
- Fill-or-kill orders

Volume

Open interest

Commitments of traders

Pricing of futures

Hedging

- Basis risk

Speculation

Position limits

Arbitrage

Spreading

- Intramarket spreads
- Intermarket spreads

### Margins

Initial margin ("good faith deposit")

Maintenance margin

- Marking to market

Clearing margins

### Segregated funds

Segregation requirements

Not covered by SIPC

## Module 3: Security Futures

### Security Futures

Definitions

- Futures on single stocks
- Futures on narrow-based stock indexes

- Index changes from narrow to broad-based

Exchanges trading security futures

Listing requirements

Restrictions on trading security futures on foreign markets

### Contract Terms and Conditions for Security Futures Contracts

Buying security futures

Selling security futures

- No short sale requirement

Contract size

Hours of trading

Contract months/trading cycle

Last trading date

Expiration dates

Minimum price variation

Reporting requirements

- Large trader reporting levels

Position and position accountability limits

Physical delivery

Cash settlement

Strategies

- Arbitrage
- Dividend-capture

### Other Characteristics of Security Futures

Fungibility (or lack thereof)

Trading halts

- Regulatory halts
- Circuit breakers

Treatment of corporate actions

- Integral stock splits

- Non-integral stock splits
- Mergers
- Takeovers
- Spin-offs

Tax treatment

Block trading requirements

## Module 4: Regulatory Requirements for Security Futures

### Registration Requirements

Registration of markets

Registration of intermediaries with the SEC and CFTC

Registration of certain collective investment vehicles or providers of investment advice

### Sales Practices

Communications with the public  
Customer protection rules

- SIPC
- Segregated funds

Risk disclosure statement

### Margin Requirements

Initial margin

Maintenance margin

- Definition of current market value

Risk-based margins

- Strategy offsets
- Portfolio-based margining systems (not allowed)

Cross-margining

Applicability of Regulation T  
Collateral

- Type, form and use of collateral
- Acceptable collateral deposits
- Use of money market mutual funds

Computation of equity

Meeting margin calls

Account liquidation

Extension of credit

### Other Considerations

Suitability

Commissions

Account approval and documentation

Discretionary accounts

Best execution requirement

Reporting customer complaints

Anti-fraud and anti-manipulation requirements

- Section 4(b) of the CEA and 10(b) of the Securities Exchange Act
- Prohibition against trading on inside information
- Prohibition against trading ahead of research reports
- Prohibition against trading ahead of customer orders

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## Module 5: Supervision of the Offer and Sale of Security Futures

### Security Futures Principals

General requirement

Qualifications for principals and representatives

- Licensing
- Examination modules
- New candidates
- Existing candidates

### Hiring Employees

Review of securities and futures employment background

### Annual Compliance Meetings

#### Account Approval

Specific approval required

Written procedures

- Criteria used

#### Discretionary Accounts

Approval

Review of discretionary activity

#### Promotional Material and Correspondence

Review of correspondence

Review and approval of promotional material

# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Executive Representatives  
Legal & Compliance  
Operations  
Senior Management

ACTION REQUESTED BY DECEMBER 2, 2002

## Public Information Review

NASD Requests Comment on its Public Information Review Initiative

## KEY TOPICS

Public Information Review

### Executive Summary

NASD requests comment from members, associated persons, investors, investor groups, and other interested parties on a broad range of issues relating to information NASD makes public. NASD currently provides an unparalleled amount of information about firms, markets and regulation to the public. NASD's policy on public information, as established by various NASD rules, and guided by relevant federal law, has been the topic of frequent public attention. NASD has begun a corporate-wide initiative to review the information it collects or develops and the policies underlying its determination to make certain information public. The overall purpose of this initiative is to develop recommendations for a comprehensive Public Information Policy that will enhance investor protection without sacrificing the effectiveness of NASD regulatory programs or legitimate proprietary or privacy rights of member firms or their associated persons. The focus of this initiative is on information currently available to NASD, not increasing member firms' compliance or reporting obligations. Soliciting the views of NASD's constituents and the users of the information NASD makes public is a critical step in the conduct of this policy review.

NASD is considering changes that would expand the information it currently makes public, including changes to its Public Disclosure Program (PD Program).<sup>1</sup> Possible other changes include, for example, expanding the statistical information NASD makes available, increasing the broker-dealer information released and making arbitration award information more readily available to investors.

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One of the key challenges in conducting this policy review is the need to balance investor protection and an investor's ability to make informed decisions with the legitimate proprietary interests of member firms and the privacy interests of associated persons and other individuals. For example, NASD does not currently release personal information such as Social Security Number, home address or physical description of associated persons<sup>2</sup> through its PD Program, and has no plans to do so.<sup>3</sup> NASD is, however, considering expanding the information released via its PD Program to include historical form filing information and disclosure information reported by a former employer on Form U-5<sup>4</sup> as soon as the information is filed. Currently, disclosure information reported via Form U-5 is not released via the PD Program until the broker re-associates with another broker-dealer and is required to report the information via Form U-4.<sup>5</sup>

### Action Requested

NASD seeks comment from members, associated persons, investors, investor groups, and other interested parties on issues relating to its Public Information Policy review and supporting or opposing the options discussed in this *Notice*.

Comments must be received by **December 2, 2002**. Members and interested persons can submit their comments using the following methods:

- ◆ mailing written comments to NASD
- ◆ e-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com)
- ◆ submitting written comments online on NASD's Web Site ([www.nasd.com](http://www.nasd.com))

Written comments submitted via hard copy should be mailed to:

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
1735 K Street, NW  
Washington, DC 20006-1500

**Important Note:** The only comments that will be considered are those submitted in writing or by e-mail.

Before becoming effective, any rule changes developed relating to this *Notice to Members* must be submitted to and approved by the Securities and Exchange Commission (SEC).

### Questions/Further Information

Questions concerning this *Notice* may be directed to Jay Cummings, Vice President, NASD Registration and Disclosure Department, at (240) 386-4773 or Ann Bushey, Director, Regulatory Review and Disclosure, NASD Registration and Disclosure Department, at (240) 386-4724.

### Background

NASD has begun a corporate-wide initiative to review the information it makes public. The initiative involves a comprehensive review of the information collected or developed by NASD and the applicable rules and policies governing whether such information is made available to the general public. As part of the Public Information Policy review, a number of options have been identified and are being presented for comment in this *Notice*. NASD is interested in comments on its Public Information Policy generally and whether commenters support or oppose the options discussed in this *Notice*. NASD will consider these

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comments when formulating rule or policy changes to its Public Information Policy.

Some of the options relate to the expansion of NASD's PD Program. NASD established the PD Program in 1988 to provide investors with important information about the professional background, business practices, and conduct of NASD members and their associated persons. Recognizing the PD Program's value to investors, Congress passed legislation in 1990 requiring NASD to establish and maintain a toll-free telephone number to receive inquiries regarding its members and their associated persons. In 1998, NASD began providing certain administrative information (e.g., approved registrations and employment history) online via NASD's Web Site ([www.nasd.com](http://www.nasd.com)). In 1999, annual inquiries through the PD Program broke the 1,000,000 mark. In 2000, the SEC approved changes to NASD IM-8310-2 that allowed NASD to (1) release information about persons formerly associated with a member for a two-year period following the termination of their registration with NASD; (2) release information about terminated persons and firms that is provided on Form U-6 (the form regulators use to report regulatory actions)<sup>6</sup>, if such matters would be required to be reported on the Form U-4 or Form BD<sup>7</sup>; and (3) deliver automated disclosure reports, which include verbatim information submitted by filers on Uniform Registration Forms. The PD Program is structured to provide information on a per firm or per broker basis on firms or individuals identified by the requester of the information. NASD currently does not release certain information that other securities regulators may provide, particularly State securities regulators operating

under applicable state public records laws. Nor has it historically released comparative information regarding NASD firms and their associated persons.

NASD believes that the PD Program is a critical investor education and protection service, as demonstrated by the over 2 million inquiries now processed annually. The PD Program includes information on over 850,000 former and current registered individuals and over 6,000 current or former NASD registered firms. Information released through NASD's PD Program is derived from the Central Registration Depository (CRD<sup>®</sup>)<sup>8</sup> system, a registration and licensing database used by regulators throughout the securities industry to register, license and regulate securities firms and their brokers.

Through the PD Program, summary information about securities-related arbitration awards involving NASD member firms is made available to the public. In addition, NASD's Dispute Resolution division has an arrangement with the *Securities Arbitration Commentator* (SAC) to provide copies of awards for inclusion in its Web-based publication service. As part of this arrangement, individual investors may search the SAC Web Site (accessible via the NASD Dispute Resolution Web Site), using the arbitration award number, to view or copy an award. The award number is contained in a broker or firm report obtained from NASD's PD Program.

NASD has a number of systems that collect data on matters that also must be reported through the CRD system. To ensure that the information is in fact reported on a timely basis, and therefore is available to the public through the PD Program, NASD plans to implement additional cross-checks to ensure that the matters reported to these systems are timely reported to the CRD system.

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## Discussion

The SEC, States and other self-regulatory organizations release a variety of information under their respective public information policies. These organizations often publish information NASD has available in its CRD system or other systems but does not release under its current information policy. NASD believes its Public Information Policy, including IM-8310-2 and any other relevant NASD Rules, should be amended as appropriate to enable investors to receive most of this information from NASD as well.

NASD seeks comment from members, associated persons, investors, investor groups, and other interested parties on issues relating to its Public Information Policy and whether commenters support or oppose the suggestions and options set forth in this *Notice* and discussed in more detail below.

### 1. Establish a Central Gateway for Access to Public Information

NASD makes a broad range of information available to the public, mostly through its Web Sites. There is, however, no single place from which to obtain a listing of the information that is publicly available. Public information is currently spread across multiple pages on at least three different Web Sites. Information frequently is presented without explanations that put the information in context or that define how statistical information has been derived.

To make information more useful and easily accessible, NASD is considering a single web location that would: (1) list and describe the public information NASD makes available; (2) provide a contact point for questions and/or

comments regarding NASD public information; (3) consolidate access to all public statistical information; and (4) enhance the statistical information NASD makes available to include certain demographic and industry segmentation data. The end result would be a central gateway for access to NASD's public information from which an Internet user could see, at-a-glance, the types of information NASD makes available and link to the specific or more detailed information he or she is interested in.

NASD seeks comment on other ways it can facilitate investor access to this information.

### 2. Enhance NASD's Public Disclosure Program

Over 2 million inquiries a year are processed through NASD's PD Program. It has become the primary source for investors and others seeking information about NASD member firms and their associated persons. To enhance investor protection, NASD believes that substantial changes should be made to its PD Program to:

- ◆ make it easier to use;
- ◆ provide disclosure information online;
- ◆ alert investors to key changes in available information about a broker or firm;
- ◆ put the information provided in context; and
- ◆ expand the types of information released through the PD Program.

Even with an expansion of the information available through the PD Program, there will be information available through other sources that is not available to NASD or that NASD is

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unable to make public.<sup>9</sup> For example, NASD does not have information regarding certain complaints made by investors to State regulators. The only source for this information is the State regulator. NASD believes the PD Program should provide investors and other users with additional information about other sources of information on NASD member firms and associated persons, including the SEC, States, other self-regulators, and, where possible, provide additional contact information for these sources.

#### *Ease of Use - Redesign of Internet Application*

NASD's Public Disclosure Internet application was initially deployed in 1998, with subsequent enhancements made in 1999 and 2000. Although NASD's PD Program Internet application was designed to be simple and efficient in its delivery of information, the Internet technology and standards available today offer significant opportunities to make NASD's PD Program easier to use and the information presented easier to understand.

To meet the needs of investors and other users, the PD Program must both provide a summary view of the wealth of detailed information that is available and the capability to view the detailed information. These two goals can best be achieved through an Internet-based approach using hyperlinks and other information architecture and presentation techniques.

#### *Online Access to Disclosure Information*

The information provided through the PD Program can be divided into two broad categories:

- ▶ **Administrative Information** – information about the firm or broker (registrations, employment history, types of business, etc.). Administrative information is available online and in Public Disclosure reports available by mail or e-mail.
- ▶ **Disclosure Information** – information provided in response to the disclosure questions on the Uniform Registration Forms (criminal, regulatory, disciplinary, customer sales practice complaints and related litigation or arbitration, etc.). Disclosure information is not available online and can only be obtained by requesting a Public Disclosure report by mail or e-mail.

The existing federal law mandating the PD Program, enacted in 1990, does not address providing disclosure information online. At the time the legislation was enacted, the PD Program was telephone-based. Investors and other users called the NASD Hotline (800-289-9999) to request reports and the legislation specifically reflected that medium for communication; Internet and online disclosure was not contemplated. Today, although the NASD Hotline is still available, investors and other users prefer to use the Internet and have expressed the strong desire to be able to obtain disclosure information online. Over 95 percent of the inquiries to the PD Program are now received through the Internet.

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NASD believes it should continue to seek a change to the federal legislation governing the PD Program to provide for online presentation of disclosure information. Without the ability to display all data online, access to information and usability of the PD Program will continue to be hampered to the detriment of investor protection.

#### *Public Disclosure Report Updates*

NASD believes that current Internet technology provides a cost-effective means to provide investors and other users of the PD Program with e-mail notice if significant changes occur to the information available on a broker or member firm specified by an investor or other user of the PD Program.

NASD is considering adding functionality to the PD Program that would allow an investor or other user of the PD Program to request an e-mail notice when certain changes occur in the information previously provided to the investor or other user through the PD Program.

#### *CRD Data and Form Filing Information*

NASD has expanded the amount of information available through the PD Program since its inception in 1988. The most recent changes occurred in February 2000.<sup>10</sup> Although a broad range of information available to regulators through the CRD system also is available to investors and others through the PD Program, NASD believes that more CRD information should be made publicly-available through the PD Program.

For example, NASD's PD Program does not release a broker's exam history or results<sup>11</sup> or other CRD system processing results; or the specific form filings and related information submitted during the course of a broker's career.<sup>12</sup> NASD also

does not release the date and reason for termination as reported on Form U-5. Further, as noted above, disclosure events reported via Form U-5 are disclosed only when (and if) a broker re-associates with another firm and is then required to report any new disclosure events via the Form U-4 filing submitted in connection with that application for registration. Similarly, the "firm information" currently disclosed through the PD Program does not include all information reported on Form BD, such as information regarding direct and indirect owners and control affiliates, answers and related details to all Form BD questions, disclosure information reported for control affiliates,<sup>13</sup> or the actual initial Form BD and amendment filings submitted from time to time to keep a firm's CRD record current.

Given that state regulators and the SEC consider these form filings to be public documents,<sup>14</sup> and with respect to Form BD, given that firms, as commercial entities, do not have the privacy interests of individual brokers, NASD seeks comment on whether or not it should expand the information released through its PD Program pursuant to IM-8310-2 to include some or all of the additional information described above – or any other information not specifically mentioned in this *Notice*. For example, should NASD expand its PD Program to include additional information reported on current Uniform Forms and provide investors access to historical form filings that may include disclosure events that are no longer reportable?

In considering any expansion of the information released through the PD Program, NASD will continue to balance the benefits of making this information available against the legitimate proprietary interests of member firms

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and the privacy interests of associated persons and other individuals whose information might be subject to disclosure. For example, NASD does not currently release personal information such as Social Security Number, home address or physical description of associated persons, and has no plans to do so. Further, NASD does not intend to disclose the date of termination and/or reason for termination as reported on Form U-5 until such time as the Form U-5 is amended to allow firms to correct any filing errors made in reporting the date or reason for termination.<sup>15</sup>

NASD also seeks comment on whether it should provide a means for former brokers to file a response to information filed on Form U-5 by a firm with which they were associated or filed by a regulator on Form U-6. Further, NASD seeks comment on whether such a response should be through a Uniform Registration Form filing (either an existing form or a new form created for this purpose) and whether such response should be included in the CRD system and the PD Program or whether such response should be filed exclusively with NASD and made available only through the PD Program.

#### *Putting the Information in Context*

Although NASD cannot rate brokers or firms or specifically advise an investor whether or not to conduct business with a particular broker or firm, NASD believes that expanding the information available through the PD Program to include certain comparative information would help an investor better understand and evaluate the information on the specific broker or firm he or she may be interested in or how his or her broker or firm compares to the rest of the industry.

NASD seeks comment on whether or not to expand the information released through the PD Program to include comparative information to help put the specific broker or firm information into context. For example, NASD proposes adding comparative information such as the total number of active brokers or firms, certain industry averages, the universe of active brokers or firms that have disclosure, the average number of disclosure events by category for brokers or firms that do have disclosure, and possibly breaking down the total number of disclosure events for a broker or firm by the number of disclosure events initiated in the past 1, 3, or 5 years or that occurred more than 10 years ago.

#### *Comment on the Public Disclosure Program*

In addition to the specific issues for comment identified in this section, NASD seeks comment on the PD Program in general, including comment on: making disclosure information available online; expanding the information made available through the PD Program; the overall design and delivery of information available via the Public Disclosure Internet application (accessing the application, navigation, online delivery of the information, display and usability of the data); and a Public Disclosure report update service (including the types of events that would trigger an update).

### **3. Implement Additional Safeguards to Ensure Timely Reporting of Disclosure Information.**

The largest and most visible component of NASD's Public Information is the PD Program. The PD Program depends largely on the system of firm and broker

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self-reporting to the CRD system through the uniform registration forms. Although there are a broad range of safeguards<sup>16</sup> in place today that serve as a “check and balance” to the overall self-reporting process, NASD believes more can be done across NASD regulatory systems to ensure data integrity, reduce or eliminate reporting gaps, and ensure that the information is reported quickly, thereby providing investors and the general public with the most current and complete information. NASD also believes that these additional safeguards will not increase an individual or firm’s current reporting obligations or add significant burdens to firm compliance activities and requirements.

In this regard, NASD is considering the following additional safeguards to help achieve its objectives:

- ◆ Expand existing NASD staff review of sources of information other than the CRD system to ensure that information required to be reported by firms and brokers through the CRD system is filed in a timely manner.
- ◆ Implement a new NASD agent registration status called “Inactive Disclosure Review” that would be applied whenever NASD staff discovers that an individual in an approved NASD registration status fails to meet a reporting requirement or fails to respond to a staff request for disclosure or related information within a prescribed period of time. This “Inactive Disclosure Review” status would parallel the existing “Inactive CE” and “Inactive Prints” agent registration statuses. A representative with this status would not be permitted to conduct sales or other regulated activity until the reporting obligation or response to the staff’s request is satisfied.
- ◆ Impose a late disclosure filing fee whenever a new disclosure event, or a required update to an existing disclosure event, is reported to NASD more than 30 days<sup>17</sup> from the date triggering the reporting obligation (e.g., the date the action was initiated or the date the firm or individual learned of the facts or circumstances giving rise to the reporting requirement).<sup>18</sup>
- ◆ Require all registered individuals (approximately 7.5 percent of registered representatives) who have not yet filed a Form U-4 amendment electronically through the CRD system to do so. This will ensure that regulators and the investing public have access to information reported on the current registration forms and verified by the filing broker and firm.<sup>19</sup>
- ◆ Establish a web page on NASD’s Web Site where investors, attorneys or others can report instances where they believe a particular disclosure event that is required to be reported via Form U-4, Form U-5, or Form BD has not been reported. The underlying premise of this proposal is that an investor or other interested individual would alert NASD of the potential reporting requirement after viewing an individual or firm’s Public Disclosure information and seeing that the specific event in question (e.g., complaint or arbitration they had filed) is not included as part of the broker or firm’s public disclosure record.

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NASD seeks comment on the safeguards noted above and any additional safeguards that NASD should consider.

#### **4. Improve Ease of Access to Arbitration Awards.**

NASD developed the *Securities Arbitration Commentator (SAC)* portal to provide access to arbitration awards for parties in subsequent arbitration cases. As part of the arbitrator selection process, parties are entitled to review the background of all potential arbitrators for their case, including prior decisions of those arbitrators. For each potential arbitrator, NASD provides parties with a report containing extensive background information and a list of that arbitrator's prior awards. With that list, parties can easily view or print awards at any time with no charge. This mechanism was designed to replace a system in which the parties requested copies of awards from NASD. Many requests were extensive and the more voluminous requests resulted in fees charged to parties.

SAC collects arbitration awards from NASD, from other self-regulatory organizations, and from the American Arbitration Association. SAC is in business to provide award summaries and searches of its award database for a fee. SAC's customers are typically attorneys for parties in arbitration matters. However, it may be possible for NASD to work with SAC to enhance the services available to individual investors in a public disclosure context. In addition, the PD Program could be enhanced to identify awards in a way that would allow more meaningful searches using the current SAC database.

NASD seeks comment on these approaches and other issues regarding the availability of dispute resolution information.

#### **5. Other NASD Information**

NASD collects a broad range of information to fulfill its regulatory mission. Because of the proprietary and confidential nature of much of this information, and its potential use in investigations, examinations or disciplinary actions, NASD believes that this information should remain non-public. In assessing whether this information should be made public, NASD initially has concluded to implement the safeguards described above to ensure that the regulatory information most pertinent to investors (*i.e.*, the information generally elicited by the uniform registration forms) is timely and fully reported to the CRD system (so it is available to regulators) and the PD Program so that it is available to investors and other users.

NASD seeks comment on this proposed approach and on any other information that NASD should consider making publicly available.

#### **Summary**

As previously stated, NASD currently provides an unparalleled amount of information about firms, markets and regulation to the public. NASD's policy on public information, as established by various NASD rules, and guided by relevant federal law, has been the topic of frequent public attention. NASD has undertaken a corporate-wide initiative to review (1) the information it collects or develops and (2) the policies underlying its determination to make certain information public. The overall objective of this initiative is to develop recommendations for a comprehensive Public Information Policy that will enhance investor protection without sacrificing the effectiveness of NASD

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regulatory programs or legitimate proprietary or privacy rights of member firms or their associated persons, or increasing member firms' compliance obligations or burdens. Soliciting the views of NASD's constituents and the users of the information NASD makes public is a critical step in the conduct of this policy review.

As discussed in this *Notice*, NASD is considering changes that would expand the information it currently makes public, including changes to its PD Program.

One of the key challenges in conducting this policy review is the need to balance investor protection and an investor's ability to make informed decisions with the legitimate proprietary interests of member firms and the privacy interests of associated persons and other individuals.

NASD believes that a more comprehensive Public Information Policy will enhance investor protection without sacrificing the effectiveness of NASD regulatory programs. NASD looks forward to receiving comments from members, associated persons, investors, investor groups, and other interested parties on the broad range of issues related to information NASD makes public and on whether commenters support or oppose the options discussed in this *Notice*.

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## Endnotes

- 1 NASD Interpretive Material (IM) 8310-2(a) governs the information released via NASD's PD Program.
- 2 This information is required to be reported by associated persons registered with NASD on their Uniform Registration Form U-4.
- 3 Other regulators may make this information public, depending on applicable law. See Note 9, below.
- 4 Form U-5: The Uniform Termination Notice for Securities Industry Registration.
- 5 Form U-4: The Uniform Application for Securities Industry Registration or Transfer.
- 6 Form U-6: Uniform Disciplinary Action Reporting Form.
- 7 Form BD: Uniform Application for Broker-Dealer Registration. Form BD is an SEC form. As such, the SEC must adopt any proposed changes to Form BD.
- 8 NASD operates the CRD system in accordance with an agreement with the North American Securities Administrators Association (NASAA). CRD policy is jointly established by NASD and NASAA.
- 9 NASD's PD Program is governed by federal law, SEC regulations, and NASD rules approved by the SEC. Other sources may be governed by different substantive legal requirements. State disclosure programs are governed by state law, which may enable the State to provide additional information on firms or brokers licensed by the state.
- 10 Broker information currently released via the PD Program includes the broker's name and CRD number, approved registrations (provided the individual is NASD registered), 10 years of employment history (includes current and previous employment), "other business" (if any) as reported on Form U-4, and all disclosure events currently required to be reported on Form U-4 (including disclosure events reported by regulators via Form U-6, and disclosure events reported by previously employing NASD firms via Form U-5 once a subsequent Form U-4 is submitted and the individual is then required to report any new disclosure events via Form U-4). Information released through the PD Program on current and former NASD registered firms includes: applicant's name, CRD number, SEC number, main office address, mailing address, business telephone number, NASD district office assignment, approved registrations (provided the firm is NASD registered), all disclosure events involving the firm required to be reported on Form BD (including disclosure events reported by regulators via Form U-6), and summary information about securities (or commodities) related NASD arbitration awards.
- 11 Exam information includes: exams requested, taken or not taken, and exam results (i.e., pass/fail or specific grades). NASD proposes providing pass/fail instead of actual scores in part because the number of questions and the required passing score varies from exam to exam and can change over time. Exam scores are not designed to predict performance or future regulatory compliance.
- 12 Historical form filing information includes the specific form filings submitted to the CRD system and the information contained in the specific filing, including any disclosure events that were reported in error or that were required to be reported on a specific filing but are no longer reportable on the individual's current Form U-4 filing (based on a change to the question or a "sunset" provision within the question that requires reporting only for a specified period of time).
- 13 Control affiliate disclosure can be obtained (if reported to the CRD system) by a separate request for information on the control affiliates.
- 14 Forms U-4, U-5, U-6, BD, BDW and related amendment filings.
- 15 The Form U-5 and related instructions do not currently allow firms to amend any information reported on the form other than the associated person's residential address and disclosure information. As a result, firms that may make filing errors by entering an incorrect date or selecting an incorrect reason for termination from a drop down list have no mechanism to correct these errors via a Form U-5 amendment filing.

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- 16 Today's safeguards include, but are not limited to: Criminal History Record Information (CHRI) received from the Federal Bureau of Investigation as part of the fingerprint card processing results, which provides an independent source of criminal history information (fingerprint cards are submitted to NASD pursuant to Exchange Act Rule 17f-2); regulator reporting of disciplinary actions initiated against a broker or firm via Form U-6; and existing information sharing within NASD departments and among other regulators.
- 17 Note that 30 calendar days is used here as an example. The requisite number of days is to be determined; however, it likely would be based on calendar days, and would be at least 30 days, except in cases involving a statutory disqualification. NASD's By-Laws, Article IV, Section 1(c ) and Article V, Section 2(c ), state that all applications with NASD must be kept current at all times by supplementary amendments and that such amendments should be filed with NASD not later than 30 days after learning of the facts or circumstances triggering the amendment filing requirement. Further, if the amendment involves a statutory disqualification as defined in Section 3(a)(39) and Section 15(b)(4) of the Exchange Act, the By-Laws state that the amendment should be filed not later than 10 days after the disqualification occurs.
- 18 The intent of the late filing fee is not to generate revenue, but rather to deter late filing and ensure that the required amendment filings are submitted timely, thereby making the information available to the public as soon as possible. The fee would be imposed any time a reportable event was initially disclosed more the 30 days from the event date.
- 19 In substantially all cases, the information provided through the PD Program represents the verbatim record as it was reported to NASD on the uniform registration form then in effect. The disclosure and other questions on these forms have changed substantially over time. In addition, in certain limited circumstances relating to the conversion to electronic form filing, NASD combined information about a single event that was reported by different sources. Filing electronically on the current form would address both issues. No fee would be charged member firms for this filing, unless the filing reported new or updated disclosure, in which case the standard disclosure review fee would apply.
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# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Compliance  
Legal  
Operations  
Senior Management

## KEY TOPICS

NASD By-Laws  
Trading Activity Fee  
Section 8(a) Regulatory Fees

## INFORMATIONAL

### Trading Activity Fee

NASD Provides Additional Information on the Trading Activity Fee

### Executive Summary

As announced in *Notice to Members 02-41* and *Special Notice to Members 02-63*, NASD has amended Section 8(a) of Schedule A to NASD's By-Laws, eliminating the Regulatory Fee and instituting a new transaction-based Trading Activity Fee which funds NASD's member regulatory activities.<sup>1</sup>

### Questions/Further Information

Questions concerning this *Notice* should be directed to NASD Finance, at (240) 386-5397, or NASD Regulatory Policy and Oversight, Office of General Counsel, at (202) 728-8071.

### Discussion

NASD has amended Section 8(a) of Schedule A to NASD's By-Laws to eliminate the Regulatory Fee and to institute a new transaction-based Trading Activity Fee. This fee is used by NASD solely to fund NASD's member regulatory activities, including the supervision and regulation of members through examinations, processing of membership applications, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. The Trading Activity Fee does not fund Market Regulation activities which are funded solely through contracts with NASDAQ and other exchanges.

These changes were originally submitted to the Securities and Exchange Commission (SEC) for immediate effectiveness. On Friday, October 18, 2002, NASD filed with the SEC two subsequent but related rule filings. The first is a proposed rule change<sup>2</sup> filed with the SEC for immediate effectiveness that established a sunset provision that terminates on December 31, 2002 the proposed

02-75

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changes made to Schedule A to NASD's By-Laws. The second rule filing<sup>3</sup> contains substantially the same rule language as originally proposed, but was submitted pursuant to Section 19(b)(1) of the Act<sup>4</sup> to allow for an additional notice and comment period. NASD filed this in response to comments made by NASD's members that the Trading Activity Fee should not be filed as immediately effective, but instead should be given a full notice and comment period. In addition, this subsequent comment period allows NASD to further examine the impact of the Trading Activity Fee rates effective upon implementation and ensure they are consistent with NASD's overall intention that amendments to its pricing structure be revenue neutral.<sup>5</sup>

### Trading Activity Fee Initial Rate Structure

NASD previously announced the initial rate structure for the Trading Activity Fee effective October 1, 2002. Based on further analysis of trading volumes and feedback from member firms, the rate structure has been further adjusted, retroactively effective to October 1, 2002. Adjustments to the rate structure are: 1) the initial rate of \$0.0001 for covered equity securities has been reduced to \$0.00005, 2) the maximum on covered equity securities has been reduced to \$5.00, 3) the initial rate of \$0.08 for security futures has been reduced to \$0.04, and 4) the minimum exclusion has been extended to cover options and futures. The adjusted rate structure is as follows:

- ◆ Each member shall pay to NASD \$0.00005 per share for each sale of a covered equity security, with a maximum charge of \$5 per trade.

- ◆ Each member shall pay to NASD \$0.002 per contract for each sale of an option.
- ◆ Each member shall pay to NASD \$0.04 for each round turn transaction of a security future.

Additionally, if the execution price for a covered security is less than the Trading Activity Fee rate (\$0.00005 for covered equity securities, \$0.002 for covered option contracts, or \$0.04 for a security future) on a per share, per contract, or round turn transaction basis then no fee will be assessed.

NASD is filing the above initial rate structure with the SEC for immediate effectiveness. Additionally, NASD intends to file any further modifications to the Trading Activity Fee rate structure with the SEC.

### Submission/Payment Information

Traditionally, the Section 8(a) Regulatory Fee had been assessed on clearing firms on behalf of members. Although reporting obligations are ultimately the responsibility of the member, the Trading Activity Fee will continue to be assessed directly to the clearing firms responsible for clearing the transaction on behalf of the member firm.

In consideration of programming constraints and due to the further refinement of the initial rate structure, NASD has extended the submission and payment date for the October 1, 2002 through December 31, 2002 time period. Firms may self-report and remit payment to NASD for this time period no later than January 15, 2003.

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The prescribed form of the monthly report is available on the NASD Web Site at [www.nasd.com](http://www.nasd.com). Firms will be required to self-report to NASD the aggregate shares for stocks, aggregate number of contracts for options, and/or aggregate number of contracts traded on a round turn basis for security futures products at the clearing firm level only. For the October 1, 2002 through December 31, 2002 time period, a separate form for each month must be submitted.

The monthly report and payment may be submitted to NASD by either US mail or overnight Express mail as follows:

**For US mail delivery:**

NASD  
P.O. Box 7777-W8555  
Philadelphia, PA 19175-8555

Note: This P.O. Box will not accept courier or overnight deliveries.

**For courier & overnight deliveries:**

NASD  
W8555 c/o Mellon Bank, Rm 3490  
701 Market Street  
Philadelphia, PA 19106  
Phone number: 215-553-0697

(if required for the recipient)

If other payment methods are required, please call NASD Finance, at 240-386-5394.

## Questions and Answers

**Question 1:** The answer to Question 4 in the Question and Answer Section of *Special Notice to Members 02-63*, stated that although the general model is to assess the Trading Activity Fee on the sell side of

member transactions, the Trading Activity Fee would be assessed on the buy side of member transactions where the counter party is not a broker/dealer. The answer further stated that NASD members will be charged a Trading Activity Fee when they are on the buy-side of a transaction with a non-broker/dealer (e.g., internalized trade). Since the rule states that each member shall pay a fee for each sale of a covered security, does this mean that for a transaction in which the sell-side is a customer and the buy-side is a member, two fees will be charged?

No. More simply stated, a fee will be assessed on all sell side transactions. This includes both transactions where the sale is for the account of a customer and transactions where the sale is for the member itself.

**Question 2:** If a member effects a sale for a customer on an agency basis, will the member be assessed a fee?

Yes. If a member acts as agent for a non-broker/dealer customer in the sale of a covered security, the member will be assessed a fee for that transaction.

**Question 3:** If a member effects a sale for another NASD member on an agency basis, will the member acting as agent be assessed a fee?

No. If a member acts as agent on behalf of another NASD member in the sale of a covered security, the fee will be assessed to the member who is the ultimate seller of the security, not the member acting as agent.

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**Question 4:** How is the Trading Activity Fee calculated when a member uses an average price model to effect transactions on an agency basis for its customers?

A member may choose to calculate the Trading Activity Fee on either the individual street side executions or on the account level average price confirmation if that member can link the street side executions to the account level average price confirmation(s). However, the methodology chosen by the member to calculate the fee assessment must be consistently applied to all average price transactions and must be documented by the member.

**Example 1.** A customer places an order to sell one million shares of a covered security and the member executes ten 100,000 share trades that are then allocated to the customer on an average price basis. If the member can link the ten street side trades to the one million share average price confirmation to the customer, the member may calculate the fee based on either the ten street side trades (ten sales at \$5) or on the account level average price confirmation to the customer (one sale at \$5).

**Example 2.** An investment advisor places an order to sell one million shares of a covered security. The member then executes ten 100,000 share trades to fill the investment advisor's order. The investment advisor subsequently allocates the one million shares to four separate customers. If the member can link the ten street side trades to the four account level average price confirmations, the member may calculate the fee based

on either the ten street side trades (ten sales at \$5) or on the account level average price confirmations (four sales at \$5). The member may not calculate the fee based on the million share order from the investment advisor (one sale at \$5) because it is comprised of multiple customer accounts.

**Question 5:** Schedule A to NASD's By-Laws, Section 2(b)(3)(iii) states "each member shall pay to NASD a fee for each round turn transaction (treated as including one purchase and one sale of a contract of sale for future delivery) of a security future". Does this mean that the fee will be assessed on a per contract basis?

Yes. Example: A member opens a position (long or short) of 100 contracts. No fee is assessed when the position is opened because the fee assessment is based on a round turn transaction. The member later closes half of its original 100 contract position. When the member closes out the 50 contracts, it will be assessed a fee of  $\$0.04 \times 50$  contracts, totaling \$2.

**Question 6:** Will the Trading Activity Fee be assessed on transactions for non-member broker-dealers who clear through an NASD member broker-dealer.

No. The Trading Activity Fee only applies to NASD member firms. However, if the NASD member clearing firm also acts as the executing broker in a transaction, then the NASD clearing member will be assessed a fee for that transaction.

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**Question 7:** The rate structure includes a maximum charge per trade of \$5 for covered securities. Does this apply to options and security futures?

No. The maximum charge was established for equity securities, particularly for the very low priced over-the-counter securities that often trade in large share quantities.

## Endnotes

- 1 These changes were submitted to the SEC (for immediate effectiveness) on July 23, 2002 and amended on August 21, 2002. See Securities Exchange Act Release No. 46416 (August 23, 2002), 67 FR 55901 (August 30, 2002) (SR-NASD-2002-98).
  - 2 See SR-NASD-2002-147.
  - 3 See SR-NASD-2002-148.
  - 4 15 U.S.C. 78s(b)(1).
  - 5 This proposed rule filing is to be read in conjunction with SR-NASD-2002-99. The two separate yet related rule filings are the result of a review of the overall NASD pricing structure and will be used to fund NASD's member regulatory activities.
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# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Corporate Finance  
Legal and Compliance  
Operations  
Senior Management  
Technology  
Trading and Market Making  
Training

## KEY TOPICS

Debt Securities  
Dissemination  
Operations  
Rule 6200 Series  
Transaction Reporting

## INFORMATIONAL

### Corporate Debt Securities Transactions Subject to Reporting and Dissemination

NASD Issues Interpretive Guidance to the Trade  
Reporting and Compliance Engine Rules (TRACE Rules)

#### Executive Summary

NASD requires members to report corporate debt securities transactions to NASD and subjects transaction information of certain categories of securities to dissemination pursuant to the Trade Reporting and Compliance Engine (TRACE) rules (TRACE Rules). On June 28, 2002, the Securities and Exchange Commission (SEC) approved amendments to the TRACE Rules (the Rule 6200 Series).<sup>1</sup> On July 1, reporting and dissemination under TRACE began and the TRACE Rules, as amended on June 28, 2002, became effective.<sup>2</sup> In this *Notice to Members (NtM)*, NASD addresses a number of interpretive issues that have arisen since TRACE began. In addition, the revised TRACE Rules are set forth in Attachment A.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to [tracefeedback@nasd.com](mailto:tracefeedback@nasd.com).

#### Interpretive Matters: Questions and Answers

The following interpretive Questions and Answers address a variety of interpretive issues that have arisen since the TRACE Rules took effect. They also respond to specific questions NASD has received since TRACE began. The staff will continue to address open interpretive issues under the TRACE Rules in subsequent *NtMs*.

02-76

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1. **How much time does a member have to resubmit a trade report that was rejected?**

NASD staff understands that in the initial phase of TRACE reporting, there may be incidences of trade reports being rejected by the TRACE System while members become familiar with TRACE reporting requirements and systems.<sup>3</sup> The staff also understands that certain members are relying on technology that reports transactions to and receives verification of accepted reports back from TRACE via a “batch” process. This “batch” process may add time to the identification and correction of trade reports initially rejected by the TRACE System. Therefore, initially, the staff expects that members will correct and resubmit rejected trade reports that are “high priority reports,” as defined below, as soon as practicable but not later than 2½ hours after execution. For “low priority reports,” as defined below, the staff expects that members will correct and resubmit rejected reports as soon as practicable, but not later than the end of the reporting day on the day of execution (or the first business day following the day of execution, if the transaction occurs on a non-business day).

**High and Low Priority Reports.** If a report details a transaction in a debt security that is listed in TRACE Rule 6250(a) as eligible for dissemination, the report is a “high priority report.” Currently, only certain very large issues of Investment Grade<sup>4</sup> securities, and approximately 50 Non-Investment Grade securities<sup>5</sup> are listed in Rule 6250(a).<sup>6</sup> If a report concerns a transaction in a debt security that is not subject to dissemination under Rule 6250(a), the report is a “low priority report.”

Regardless of the reporting mechanism used by the member (e.g., batch submission, Computer-to-Computer Interface (CTCI), Web browser, or third party intermediary reporting systems), any rejected trade reports should be

corrected and resubmitted to TRACE as soon as possible by the reporting member. NASD will be monitoring members’ reporting to ensure that members have procedures in place that are reasonably designed to ensure that rejected trade reports are identified, corrected, and resubmitted in a timely manner. Patterns and practices of late submissions due to rejections may be considered a violation of the TRACE Rules and Rule 2110.

2. **Do the clock synchronization rules that apply in OATS apply to TRACE?**

Yes. Under NASD Rule 6953, “Synchronization of Member Business Clocks,” all members with an obligation under any NASD rule to record the date and time of any event (such as the time of execution of a transaction under TRACE Rule 6210(d) and Rule 6230(c)) must synchronize their business clocks, including computer system clocks and mechanical clocks. The clock synchronization requirements apply to all members with a time-reporting obligation under any NASD Rule, and therefore apply to all members in reporting under the TRACE Rules. For more information about clock synchronization requirements and frequently asked questions, refer to “The NASD Provides Guidance On OATS Clock Synchronization,” RCA (December 1998), [http://www.nasdr.com/3050\\_9812.htm](http://www.nasdr.com/3050_9812.htm).

3. **How does a member report the date and time of execution of a transaction executed on a weekend or a holiday?**

The TRACE Rules recognize that transactions in TRACE-eligible securities may occur at any time. In Rule 6230(a)(1)-(4), NASD established specific reporting periods. In Rule 6230(a)(4), NASD describes how to report when a transaction is executed during a weekend or on a holiday. Initially,

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the TRACE System is not able to recognize, and will reject, a transaction report that includes a calendar date that is a Saturday, Sunday, or a federal or religious holiday on which the TRACE System is closed. In addition, the TRACE System will reject a date in the "as/of" field for the same reason. Therefore, the actual date of transactions that are executed on a non-business day cannot be captured electronically at this time. Until the TRACE System is revised, Rule 6230(a)(4) requires members to report transactions that are executed on a non-business day as follows. A member must report the transaction on the first business day following the actual date of the transaction within one hour and fifteen minutes of the opening of the TRACE System. The transaction date must be reported as the first business day after which the transaction occurred (the same day of the report). The time of execution must be reported as "00:01:00" (military time for 12:01:00 a.m., Eastern Time). This will distinguish the limited number of weekend and holiday transactions from transactions actually occurring on the business day. The modifier, "special price," must be selected. In addition, when the reporting method chosen provides a "special price memo" field, the member must enter the actual date and time that the transaction occurred.<sup>7</sup>

**4. If a member executes a transaction overseas, what time (and day) should the member use to report?**

Time of execution must be reported in military time based on Eastern Time (e.g., a transaction that occurs at 3:30:30 p.m., Eastern Time would be reported as "15:30:30"). Since the TRACE System is based upon Eastern Time, all trade reports must be submitted based on the time the transaction occurred, converted to Eastern Time, even if the local date and time of the

reporting party and other parties to the transaction are not Eastern Time.<sup>8</sup>

**5. How should a member report a transaction when the market and the TRACE System close early and a transaction is executed after the market closes?**

When NASD announces an early market closing (or follows the early market closing announced by another self-regulatory organization), transactions that occur after the TRACE System closes on that business day should be reported according to Rule 6230(a)(2), which describes how to report "after system hours" for transactions that occur on a business day. Thus, the transaction report will include the day of execution (using the as/of feature) and the actual time of execution. The report must be filed within one hour and 15 minutes on the next business day that the TRACE System is open. For example, if NASD announces that the TRACE System will be open from 8:00 a.m. to 2:00 p.m., and that day a member executes a trade between 2:00 p.m. and 6:29:59 p.m., Eastern Time (e.g., 2:45 p.m., Eastern Time), the member will correctly and timely report the transaction if the member reports it the next TRACE business day, within one hour and 15 minutes after the TRACE System opens, reporting the transaction "as/of (month/day/year)," with time of execution (e.g., 14:45:00 p.m., Eastern Time).

**6. Has NASD staff identified specific instances, other than those identified in Rule 6230(c)(13), when yield is not required to be reported?**

Yield is a required element in reporting a debt securities transaction. However, paragraph (c)(13) of Rule 6230 sets forth specific exceptions from the requirement. In addition, the rule provides that yield is not

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required to be reported “where the principal or interest to be paid is an unknown variable or is an amount that is not currently ascertainable, or any other security that NASD designates if NASD determines that reporting yield would provide inaccurate or misleading information concerning the price of, or trading in, the security.”

NASD does not believe it is possible to identify, before each occurrence, all the instances in which it is not appropriate or useful to report yield. Instead, NASD has clarified that in those instances where the reported yield would provide inaccurate or misleading information concerning the price of, or trading in, the security, NASD will designate additional types or specific securities where yield is not required to be reported.

**Security In Default.** Under one of the exceptions in Rule 6230(c)(13), a member is not required to report yield for a transaction in a security in default. Members have asked how default is interpreted under the Rule, or when it occurs. Under Rule 6230(c)(13), when market participants have begun to trade a bond “flat” in anticipation of a formal announcement (e.g., of a default, a bankruptcy, a filing seeking reorganization under Chapter XI, 11 U.S.C. §§1101 et seq. (2002), or any other official announcement that the company will not meet its financial obligations), but the official announcement has not occurred, a broker/dealer must indicate in its report that it is trading the bond “flat” using the “special price” indicator and, if available, the “special price memo” field. In such cases, yield is not required to be reported. When a formal announcement, made on behalf of and authorized by the issuer, has been disseminated in the market, yield is not

required to be reported, *and* the special price indicator and the “special price memo” field would not be used.

**7. May a member report a yield on which the security is priced and sold, rather than the lower of yield to maturity or yield to call under Rule 6230(c)(13)?**

As modified, a member must report the lower of yield to call or yield to maturity under Rule 6230(c)(13). A member may not report yield that is calculated on a basis other than yield to call or yield to maturity. Thus, even if a member sells or buys a security at a yield other than the yield to call or yield to maturity, the member is required to report the transaction with the yield calculated using the applicable standard(s), so that yield in different transactions may be meaningfully compared.

**8. Which of the modifiers has priority over other modifiers described in Rule 6230(d)(4)?**

If the price of a transaction is determined using a weighted average price method, a member must indicate this with the modifier “.w.” The member is required to select the modifier “.w” and may not select the “special price” modifier. In addition, the weighted average price modifier, “.w,” has priority over modifiers used to indicate settlement other than “regular way.” If the weighted average price modifier, “.w,” and one of the settlement term modifiers are applicable to the transaction, “.w” must be selected when reporting the transaction. Rule 6230(d)(4)(C). (Modifiers indicating special terms of settlement are set forth in Rule 6230(d)(4)(B).)

**9. Has NASD identified instances where the “special price” modifier must be used in a transaction report?**

Under Rule 6230(c)(4)(A), a member must indicate that certain transactions have been executed at a “special price.” In addition, the reporting party must explain in the “special price memo” field, when available, why the transaction was executed at other than a current market price.

The special price modifier should be used, for example, when a TRACE-eligible security is traded in the current market with a due bill or warrant attached, with the price reflecting the special conditions of the trade. In addition, when market participants perceive that an issuer is about to go into default on a security and begin trading a security “flat” before a formal announcement, the “special price” modifier should be used. (See Q. & A. No. 6. above.) Finally, there may be instances where a transaction done pursuant to an issuer’s plan to repurchase some or all of its outstanding debt (“issuer open market repurchases”) would require using the “special price” modifier. (See Q. & A. No. 13. below.)

**10. Are there instances when the special price modifier should not be used?**

Yes. The “special price” modifier should not be used when the transaction is priced by using a “weighted average price.” “Weighted average price” is indicated using the “weighted average price” modifier, “.w,” and should be used instead of the more general modifier, “special price.”

**11. How does a member determine “time of execution” as required under Rule 6210(d) when a security is priced based on a yield of another security and that yield is not available at the time the parties decide to engage in a transaction?**

NASD amended Rule 6210(d) to clarify the term, “time of execution,” when the yield in a transaction in a TRACE-eligible security will be established by determining the yield of a “benchmark” security. Under Rule 6210(d), “time of execution” means “the time when the parties to the transaction agree to all the terms of the transaction that are sufficient to calculate the dollar price of the trade.” When a benchmark security is a reference for determining yield, the time of execution is deemed to occur when the parties to the transaction may identify and agree upon the yield for the security. For example, if the parties agree to determine the specific yield of Security A based upon a spread that is 150 points “off” (above) or “through” (below) the yield of a comparable U.S. Treasury security, and agree to measure the yield of the comparable U.S. Treasury security at 3:30 p.m. on the day of the transaction, the parties will be expected to agree upon the yield of Security A at 3:30 p.m. when the information becomes available. As of that time, the parties have knowledge of all of the elements of the transaction necessary to calculate the dollar price of the transaction, must identify them, and are obligated to report the transaction within one hour and 15 minutes.

**12. How does a member report a commission?**

If a member charges a commission in an agency transaction, the commission is reported separately under Rule 6230(c). Report the commission, stated in points per bond, with 1 point (1.00) equal to \$10.00 per bond. (The bond is assumed to be a

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conventional bond having a \$1000 par value.) If the commission is stated as a flat fee per transaction (e.g., \$100 to execute a 10 bond odd lot transaction), the member must convert the commission to points per bond to report correctly.

Ex. 1: If a "sixteenth" commission were charged (i.e., 1/16 point per bond), the commission reported would be 0.0625. If an "eighth" commission were charged (i.e., 1/8 point per bond), the commission reported would be 0.125.

Ex. 2. If a \$100 commission were charged to execute an odd lot transaction of 10 bonds, the commission reported would be 1.0 (point). If a \$100 commission were charged to execute 20 bonds, the commission reported would be 0.5 (points).

**13. When may a member rely on the exception in Rule 6230(e)(3) that a transaction executed at a price "substantially unrelated to the current market for the TRACE-eligible security" is not required to be reported?**

Rule 6230(e)(3) provides that a member is not required to report a transaction if the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the TRACE-eligible security. NASD interprets Rule 6230(e)(3) very narrowly. Generally, any one or more transactions executed in furtherance of an investment, commercial, or trading purpose will not fall within the exception of Rule 6230(e)(3). (NASD's example of a transaction (i.e., a gift) in the rule that is subject to the exception is a limited, one-time execution that occurs without reference to current market pricing and investment, commercial, or trading considerations.)

When considering if a member is excepted from reporting under Rule 6230(e)(3), a member should consider the following: (1) NASD interprets the Rule 6230(e)(3) exception very narrowly; (2) the general requirement to report any transaction in a TRACE-eligible security under Rule 6230 is interpreted broadly in furtherance of the underlying policy goals of TRACE; and, (3) in furtherance of the policy goals, paragraph (d)(4)(A) of Rule 6230 provides that transactions in TRACE-eligible securities that do not reflect current market pricing must be reported using a "special price" modifier. Thus, with few exceptions, when a transaction in a TRACE-eligible security is executed, a member is required to report the transaction. If special conditions or circumstances affect the price, when in doubt, the member should report the transaction and append the "special price" modifier described in Rule 6230(d)(4)(A).<sup>9</sup>

**Issuer Open Market Repurchase Transactions.** An issuer of debt may determine to repurchase a portion or all of an outstanding issue of debt. When an issuer engages, directly or indirectly, in repurchasing its debt in the open market, the transaction must be reported and is not subject to the exception in Rule 6230(e)(3). Generally, in such purchases and sales, market participants negotiate the price and other terms of the transaction (or multiple transactions) based on investment, commercial or trading considerations, and execute the transaction in furtherance of investment, commercial, or trading purposes. Even where an issuer, or a market participant on behalf of an issuer, determines to price and purchase a significant amount of a debt security, the price established for the transaction is determined substantially by the current market price of the security and current market conditions. Thus, regardless of the issuer's ultimate motivation, NASD interprets Rule 6230 as requiring the reporting of the

transaction. If the exception in Rule 6230(e)(3) were interpreted to apply, NASD's surveillance of the debt markets may be hampered by incomplete information relating to significant trading activity. In addition, if such transactions were subject to dissemination, the market may be deprived of significant, relevant, current price information.<sup>10</sup>

**14. When a member uses a broker's broker or an inter-dealer broker to execute a TRACE-eligible transaction, what are the reporting requirements?**

Generally when one member ("B/D X") contacts a broker's broker or an inter-dealer broker ("IDB") and executes a transaction through IDB, B/D X will be required to report and IDB, which is also a member, will be required to report. (In addition, the member ("B/D Y") on the other side of IDB is required to report.) In total, in most transactions involving an IDB, a total of four transaction reports must be filed.

Ex: B/D X contacts IDB to buy N Bond.  
IDB contacts B/D Y to sell N Bond to IDB.

Report 1. IDB reports a BUY from B/D Y of N Bond

Report 2. B/D Y reports a SELL to IDB of N Bond

Report 3. IDB reports a SELL to B/D X of N Bond

Report 4. B/D X reports a BUY from IDB of N Bond

IDB is acting in either an agency or a principal capacity. IDB buys the N Bond at a price including its mark-down (or charges a commission) and sells the N Bond at a different price, which includes a mark-up (or a commission).

**15. What is a member's obligation under the TRACE Rules to identify new TRACE-eligible securities?**

NASD amended Rule 6260 to require an underwriter to make a good faith determination of TRACE eligibility. If in doubt, the underwriter should submit the information regarding a new debt security to NASD's TRACE Operations Center. NASD then will make the final determination if a debt security is a TRACE-eligible security.

**16. When a member that is required to notify NASD of a new TRACE-eligible security under Rule 6260 has not finalized all the information, such as coupon rate and maturity, required to be submitted prior to the deadline for notification, what should the member do?**

Rule 6260(b) provides that a member that is the lead underwriter of any newly issued TRACE-eligible security shall provide to the TRACE Operations Center the following information concerning a new TRACE-eligible security: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; and (6) a brief description of the issue. The information may be provided by e-mail, facsimile, or telephone. The specific contact information is set forth in two places on the TRACE Web page, "TRACE FAQs" and "TRACE Contacts," at [www.nasd.com/mkt\\_sys/trace\\_info.asp](http://www.nasd.com/mkt_sys/trace_info.asp).

If all of the information has not been determined by the deadline for notification, the issuer may file "such other information as the NASD deems necessary" to properly identify the new issue for inclusion in the TRACE System. For example, an underwriter may notify the NASD of a new issue by providing the CUSIP number (Item 1) and Items, 2, 5, and 6 (which are, respectively,

issuer name, whether Rule 144A applies, and a brief description of the issue), in those instances where the coupon rate and the maturity have not been established. A CUSIP number, however, must always be provided.<sup>11</sup> In addition, the underwriter is required to provide the missing information, such as coupon rate and maturity, as soon as it becomes available.

**17. For a new issue, when does the primary distribution end? When does secondary market trading begin?**

Rule 6230(e)(1) provides that transactions that are part of a primary distribution are not required to be reported. Primary market distribution efforts cease when the underwriters of the offering (e.g., members of the underwriting syndicate) terminate the offering, and indicate that the issue is "free to trade."<sup>12</sup> (Usually, the termination of an offering is announced over various wire services and other instantaneous means of communication that provide immediate notification to market participants.) For purposes of reporting under TRACE, all transactions that occur as of or after the termination of the offering are secondary market transactions and must be reported.

## Endnotes

- 1 See Exchange Act Release No. 46144 (June 28, 2002), 67 Fed. Reg. 44907 (July 5, 2002) (File No. SR-NASD-2002-46). The amendments, among other things:
  - (1) extended the period to report a transaction from 1 hour to 75 minutes;
  - (2) incorporated standards in Rule 6250 for designating additional Non-Investment Grade securities for dissemination, if fewer than 50 such securities are subject to dissemination;
  - (3) required managing underwriters to provide to NASD the CUSIP number and additional identifying information about a new issue of a TRACE-eligible debt security prior to trading in the secondary market, with special provisions for issues offered on an intra-day basis;
  - (4) clarified that securities of a government-sponsored entity (GSE) are not TRACE-eligible securities;
  - (5) clarified definitions, including "time of execution," "reportable TRACE transaction," "parties to the transaction," and "money market instrument";
  - (6) clarified how to report transactions occurring before, during and after TRACE system ("TRACE System") operation hours on a business day, and on holidays and weekends;
  - (7) described various trade reporting modifiers;
  - (8) clarified how to report yield and when yield is not required; and
  - (9) required that two transaction reports be filed for "crosses."
- 2 Before the June 28, 2002 action, the SEC had approved three other rule filings in 2001 containing TRACE Rules. However, none of the TRACE Rules took effect until July 1, 2002. See Exchange Act Release No. 43873 (Jan. 23, 2001), 66 Fed. Reg. 8131 (Jan. 29, 2001) (File No. SR-NASD-99-65) (approval order); Exchange Act Release No. 44039 (Mar. 5, 2001), 66 Fed. Reg. 14234 (Mar. 9, 2001) (File No. SR-NASD-2001-04) (approval order); and Exchange Act Release No. 45229 (Jan. 3, 2002), 67 Fed. Reg. 1255 (Jan. 9, 2002) (File No. SR-NASD-2001-91) (notice of

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proposed rule and immediate effectiveness upon filing on December 13, 2001, and approval order). See NtM 01-18 (March 2001).

Because the TRACE Rules became effective less than 72 hours after the SEC approved the amendments, NASD published a complete set of TRACE Rules on the NASD Web site on June 28, 2002, to provide members notice of the revised TRACE Rules prior to the start of TRACE on July 1, 2002.

- 3 The term "reject" here refers to a TRACE report that is not accepted by the TRACE System. Therefore, no control number has been assigned to the report by the TRACE System. This differs from the situation in which a report is submitted to and accepted by the TRACE System and, therefore, a control number is assigned to the transaction report. If, for a transaction report accepted by the TRACE System, a member subsequently determines that one or more of the reported elements were submitted incorrectly, the trade report must be either corrected or "reversed." If "reversed," a new trade report is submitted to TRACE in its place.
- 4 "Investment Grade" is defined in TRACE Rule 6210(h).
- 5 "Non-Investment Grade" is defined in TRACE Rule 6210(i).
- 6 Over time, NASD expects to increase the type and number of securities for which transaction information will be disseminated.
- 7 NASD expects to modify the TRACE System so that it will accept, on a business day, transactions reported as executed on a weekend day or holiday that the TRACE System is not open (i.e., the member will submit the report on a business day during TRACE System hours, and TRACE will accept the report if the execution date states, for example, "as/of 12/25/02," as the holiday date on which the transaction was executed).
- 8 The requirement in Rule 6230 to use Eastern Time applies to reporting and records regarding reporting. Members are not required to confirm transactions to customers in Eastern Time.
- 9 Rule 6230(d)(4)(A) requires a member to select the special price modifier when a transaction "is not executed at a price that reflects the current market price."
- 10 There may be circumstances in which a member reports a transaction done pursuant to an issuer open market repurchase, and appropriately appends the "special price modifier" described in Rule 6230(d)(4)(A). In most cases, however, it appears that such issuer repurchase transactions may establish pricing in the current market for that security, rather than deviate from current market pricing.
- 11 The CUSIP number must be in the TRACE System in order for reporting to occur electronically using the System. If the appropriate CUSIP number has not been entered into the TRACE System, it will reject the transaction report, even if the security is a TRACE-eligible security.
- 12 The SEC defines "distribution" in Regulation M. "'Distribution' means an offering of securities, whether or not subject to registration under the Securities Act, that is distinguished from ordinary trading transactions by the magnitude of the offering and the presence of special selling efforts and selling methods." Regulation M, Rule 100; 17 C.F.R. 242.100. A "primary distribution" or "primary offering" is the sale of a new issue of a debt or equity security.

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## ATTACHMENT A

### 6200. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)

#### 6210. Definitions

The terms used in this Rule 6200 Series shall have the same meaning as those defined in the Association's By-Laws and Rules unless otherwise specified.

(a) The term "TRACE-eligible security" shall mean all United States dollar denominated debt securities that are depository eligible securities under Rule 11310(d); Investment Grade or Non-Investment Grade; issued by United States and/or foreign private corporations; and: (1) registered with the Securities and Exchange Commission; or (2) issued pursuant to Section 4(2) of the Securities Act of 1933 and purchased or sold pursuant to Rule 144A of the Securities Act of 1933. The term "TRACE-eligible security" excludes debt issued by government-sponsored entities, mortgage- or asset-backed securities, collateralized mortgage obligations, and money market instruments. For purposes of the Rule 6200 Series, the term "money market instrument" means a debt security that at issuance has a maturity of one year or less.

(b) The term "Trade Reporting and Compliance Engine" or "TRACE" shall mean the automated system developed by the NASD that, among other things, accommodates reporting and dissemination of transaction reports where applicable in TRACE-eligible securities.

(c) The term "reportable TRACE transaction" shall mean any secondary market transaction in a TRACE-eligible security except transactions in TRACE-eligible securities that are listed on a national securities exchange registered under Section 6 of the Securities Exchange Act of 1934, when such transactions are executed on, and reported to the exchange and the transaction information is disseminated publicly, or transactions in convertible debt securities that are listed and quoted on the Nasdaq Stock Market, Inc. (Nasdaq), when such transactions are reported to Nasdaq and the transaction information is disseminated publicly.

(d) The term "time of execution" for a transaction in a TRACE-eligible security shall be the time when the parties to the transaction agree to all of the terms of the transaction that are sufficient to calculate the dollar price of the trade. The time of execution for transactions involving TRACE-eligible securities that are trading "when issued" on a yield basis shall be when the yield for the transaction has been agreed to by the parties to the transaction. For a transaction in a TRACE-eligible security in which the actual yield for the transaction is established by determining the yield from one or more designated securities (e.g., a

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“benchmark security” such as a U.S. Treasury security maturing in 5 years, or a combination of such “benchmark securities”) and adding the agreed upon “yield spread” (e.g., 150 basis points above the benchmark security), the “time of execution” occurs when the yield has been agreed to by the parties to the transaction.

(e) The term “parties to the transaction” shall mean the introducing broker-dealer, if any, and the executing broker-dealer.

(f) The term “TRACE Participant” shall mean any NASD member that reports transactions to the TRACE system, directly or indirectly.

(g) The term “Introducing Broker” shall mean the NASD member that has been identified in the TRACE system as a party to the transaction, but does not execute or clear the transaction.

(h) The term “Investment Grade” shall mean any TRACE-eligible security rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories.

(i) The term “Non-Investment Grade” shall mean any TRACE-eligible security that is unrated, non-rated, split-rated (where one rating falls below Investment Grade), or otherwise does not meet the definition of Investment Grade in paragraph (h) above.

[Adopted by SR-NASD-99-65 eff. July 1, 2002; amended by SR-NASD-2001-91 eff. July 1, 2002; amended by SR-NASD-2002-46 eff. July 1, 2002.]

## **6220. Participation in TRACE**

### **(a) Mandatory Member Participation**

(1) Member participation in TRACE for trade reporting purposes is mandatory. Such mandatory participation obligates members to submit transaction reports in TRACE-eligible securities in conformity with the Rule 6200 Series.

(2) Participation in TRACE shall be conditioned upon the TRACE Participant’s initial and continuing compliance with the following requirements:

(A) Execution of, and continuing compliance with, a TRACE Participant application agreement and all applicable rules and operating procedures of the Association and the Commission; and

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(B) Maintenance of the physical security of the equipment located on the premises of the TRACE Participant to prevent unauthorized entry of information into TRACE.

(3) Each TRACE Participant shall be obligated to inform the Association of non-compliance with, or changes to, any of the participation requirements set forth above.

**(b) Participant Obligations in TRACE**

Upon execution and receipt by the Association of the TRACE Participant application agreement, a TRACE Participant may commence input of trade information in TRACE-eligible securities. TRACE Participants may access the service via an NASD-approved facility during the hours of operation.

[Adopted by SR-NASD-99-65 eff. July 1, 2002; amended by SR-NASD-2002-46 eff. July 1, 2002.]

**6230. Transaction Reporting**

**(a) When and How Transactions are Reported**

A member that is required to report transaction information pursuant to paragraph (b) below must report such transaction information within one hour and fifteen minutes of the time of execution, except as otherwise provided below, or the transaction report will be "late." The member must transmit the report to TRACE during the hours the TRACE system is open ("TRACE system hours"), which are 8:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time. Specific trade reporting obligations during a 24-hour cycle are set forth below.

**(1) Transactions Executed During TRACE System Hours**

Transactions in TRACE-eligible securities executed on a business day at or after 8:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time must be reported within one hour and fifteen minutes of the time of execution. If a transaction is executed on a business day less than one hour and fifteen minutes before 6:30 p.m. Eastern Time, a member may report the transaction the next business day within one hour and fifteen minutes after the TRACE system opens. If reporting the next business day, the member must indicate "as/of" and provide the actual transaction date.

**(2) Transactions Executed At or After 6:30 P.M. Through 11:59:59 P.M. Eastern Time**

Transactions in TRACE-eligible securities executed on a business day at or after 6:30 p.m. Eastern Time through 11:59:59 p.m. Eastern Time must be reported the next

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business day within one hour and fifteen minutes after the TRACE system opens. The member must indicate "as/of" and provide the actual transaction date.

**(3) Transactions Executed At or After 12:00 A.M. Through 7:59:59 A.M. Eastern Time**

Transactions in TRACE-eligible securities executed on a business day at or after 12:00 a.m. Eastern Time through 7:59:59 a.m. Eastern Time must be reported the same day within one hour and 15 minutes after the TRACE system opens.

**(4) Transactions Executed on a Non-Business Day**

Transactions in TRACE-eligible securities executed on a Saturday, Sunday, or a federal or religious holiday on which the TRACE system is closed, at any time during that day (determined using Eastern Time), must be reported the next business day within one hour and fifteen minutes after the TRACE system opens. The transaction must be reported as follows: the date of execution must be the first business day (the same day the report must be made); the execution time must be "12:01:00 a.m. Eastern Time" (stated in military time as "00:01:00"); and the modifier, "special price," must be selected. In addition, the transaction must not be designated "as/of". When the reporting method chosen provides a "special price memo" field, the member must enter the actual date and time of the transaction in the field.

(5) Members have an ongoing obligation to report transaction information promptly, accurately, and completely. The member may employ an agent for the purpose of submitting transaction information; however, the primary responsibility for the timely, accurate, and complete reporting of transaction information remains the non-delegable duty of the member obligated to report the transaction.

(6) A member may be required to report as soon as practicable to the Market Regulation Department on a paper form, the transaction information required under Rule 6230 if electronic submission into TRACE is not possible. Transactions that can be reported into TRACE, including transactions executed on a Saturday, Sunday or holiday as provided in (a)(4) above, and trades that can be submitted on the trade date or on a subsequent date on an "as/of" basis, shall not be reported on a paper form.

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**(b) Which Party Reports Transaction**

Trade data input obligations are as follows:

(1) In transactions between two members, both members shall submit a trade report to TRACE;

(2) In transactions involving a member and a non-member, including a customer, the member shall be required to submit a trade report to TRACE.

**(c) Transaction Information To Be Reported**

Each TRACE trade report shall contain the following information:

(1) CUSIP number or NASD symbol;

(2) Number of bonds as required by paragraph (d) below;

(3) Price of the transaction (or the elements necessary to calculate price, which are contract amount and accrued interest) as required by paragraph (d) below;

(4) A symbol indicating whether the transaction is a buy or a sell;

(5) Date of Trade Execution(as/of trades only);

(6) Contra-party's identifier;

(7) Capacity - Principal or Agent (with riskless principal reported as principal) as required by paragraph (d) below;

(8) Time of trade execution;

(9) Reporting side executing broker as "give-up" (if any);

(10) Contra side Introducing Broker in case of "give-up" trade;

(11) Stated commission;

(12) Such trade modifiers as required by either the TRACE rules or the TRACE users guide; and

(13) The lower of yield to call or yield to maturity. A member is not required to report yield when the TRACE-eligible security is a security that is in default; a security for which the interest rate is floating; a security for which the interest rate will be or may be increased (e.g., certain "step-up bonds") or decreased (e.g., certain

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“step-down bonds”) and the amount of increase or decrease is an unknown variable; a pay-in-kind security (“PIK”); any other security where the principal or interest to be paid is an unknown variable or is an amount that is not currently ascertainable, or any other security that the Association designates if the Association determines that reporting yield would provide inaccurate or misleading information concerning the price of, or trading in, the security.

**(d) Procedures for Reporting Price, Capacity, Volume**

(1) For principal transactions, report the price, which must include the mark-up or mark-down. (However, if a price field is not available, report the contract amount and the accrued interest.) For agency transactions, report the price, which must exclude the commission. (However, if a price field is not available, report the contract amount and the accrued interest.) Then, report the commission, stated in points per bond, with 1 point equal to \$10.00 per bond.

(2) For agency and principal transactions, report the actual number of bonds traded, with \$1,000 par value equal to 1 bond. If a bond has a par value of less than \$1,000 (“baby bond”) or the par value is not an even multiple of \$1,000, report the fractional portion of \$1,000 in decimals.

(3) For in-house cross transactions, a member must report two transactions, which are the member’s purchase transaction and the member’s sale transaction.

**(4) (A) Special Price Modifier**

If a transaction is not executed at a price that reflects the current market price, select the modifier, “special price.” When the reporting method chosen provides a “special price memo” field, state why the transaction was executed at other than the current market price in the “special price memo” field (e.g., when a debt security is traded conventionally and in the current market does not have a due bill and/or a warrant attached, but in the transaction to be reported is traded with a due bill and/or warrant attached, the price of the transaction is a “special price”). Do not select the modifier, “special price,” where the transaction price is determined using a weighted average price.

**(B) Settlement Modifiers**

If a transaction is to be settled other than the regular way, report the settlement terms by selecting the appropriate modifier. If the parties agree to

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settlement on the same day the transaction is executed (*i.e.*, cash settlement), select the modifier, “.c.” If a trade will be settled the next day, select the modifier, “.nd.” If a trade will be settled other than on the date of trade, the next day, or T+3, select the modifier, “.sNN,” and enter the appropriate number of days (*e.g.*, if a trade will be settled in 5 business days, the reporting party will enter “.s05” in the data field).

(C) Weighted Average Price Modifier

If the price of the transaction is determined using a weighted average price method, select the modifier, “.w.” If one of the settlement modifiers and the weighted average price modifier apply to the transaction, select the modifier, “.w” for weighted average price and do not report the applicable settlement modifier.

**(e) Transactions Not Required To Be Reported**

The following types of transactions shall not be reported:

- (1) Transactions that are part of a primary distribution by an issuer;
- (2) Transactions in securities that are listed on a national securities exchange, when such transactions are executed on and reported to the exchange and the transaction information is disseminated publicly, and transactions in convertible debt securities that are listed and quoted on Nasdaq, when such transactions are reported to Nasdaq and the transaction information is disseminated publicly; and
- (3) Transactions where the buyer and the seller have agreed to trade at a price substantially unrelated to the current market for the TRACE-eligible security (*e.g.*, to allow the seller to make a gift).

**(f) Compliance With Reporting Obligations**

A pattern or practice of late reporting without exceptional circumstances may be considered conduct inconsistent with high standards of commercial honor and just and equitable principles of trade, in violation of Rule 2110.

[Adopted by SR-NASD-99-65 eff. July 1, 2002; amended by SR-NASD-2001-04 eff. July 1, 2002; amended by SR-NASD-2002-46 eff. July 1, 2002.]

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#### **6240. Termination of TRACE Service**

The Association may, upon notice, terminate TRACE service to a member in the event that a member fails to abide by any of the rules or operating procedures of the TRACE service or the Association, or fails to honor contractual agreements entered into with the Association or its subsidiaries, or fails to pay promptly for services rendered by the TRACE service.

[Adopted by SR-NASD-99-65 eff. July 1, 2002.]

#### **6250. Dissemination of Corporate Bond Trade Information**

##### **(a) General Dissemination Standard**

Immediately upon receipt of transaction reports received at or after 8:00 a.m. through 6:29:59 p.m. Eastern Time, the Association will disseminate transaction information (except that market aggregate information and last sale information will not be updated after 5:15 p.m. Eastern Time) relating to transactions in:

(1) a TRACE-eligible security having an initial issuance size of \$1 billion or greater that is Investment Grade at the time of receipt of the transaction report; and

(2) a TRACE-eligible security that is designated for dissemination according to the following criteria and is Non-Investment Grade at the time of receipt of the transaction report.

(A) The staff of NASD will designate fifty of the most actively traded Non-Investment Grade securities that are TRACE-eligible securities for dissemination under this rule, based on (i) the security's volume; (ii) the security's price; (iii) the security's name recognition; (iv) the research following of the security; (v) the security having a minimum number of bonds outstanding; (vi) the security being traded routinely by at least two dealers; and (vii) the security contributing to a representation of diverse industry groups in the group of securities designated for dissemination.

(B) A Non-Investment Grade security will not be designated, and may be immediately withdrawn from designation, for dissemination under this rule if the security: (i) has matured; (ii) has been called; (iii) has been upgraded to Investment Grade; or (iv) has been downgraded to an extent that the security's trading characteristics do not warrant designation for dissemination.

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**(b) Transactions Excluded From Market Aggregate, Last Sale**

All trade reports in TRACE-eligible securities that are approved for dissemination and submitted to TRACE at or after 8:00 a.m. Eastern Time and prior to 5:15 p.m. Eastern Time will be included in the calculation of market aggregates and last sale except:

- (1) trades reported on an "as of" basis,
- (2) "when issued" trades executed on a yield basis,
- (3) trades in baby bonds with a par value of less than \$1,000,
- (4) trades in which the price is determined by a weighted average price; and
- (5) trades in which the price is a "special price," as indicated by the use of the special price modifier.

**(c) Dissemination of Certain Trades Executed on A Business Day**

(1) Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a business day at or after 6:30 p.m. Eastern Time through 11:59:59 p.m. Eastern Time, and are reported pursuant to Rule 6230(a)(2) on the next business day and designated "as/of" will be disseminated beginning at 8:00 a.m. Eastern Time on the day of receipt. The reported information will not be included in the calculation of the day's market aggregates.

(2) Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a business day at or after 12:00 a.m. Eastern Time through 7:59:59 a.m. Eastern Time, and are reported pursuant to Rule 6230(a)(3) on the same day beginning at 8:00 a.m. Eastern Time will be disseminated upon receipt. The reported information will be included in the calculation of the day's market aggregates, except as otherwise provided in Rule 6250(b)(1) through (5).

**(d) Dissemination of Trades Executed on Non-Business Days**

Reports of transactions in TRACE-eligible securities that are subject to dissemination, are executed on a non-business day at any time during the day, and are reported pursuant to Rule 6230(a)(4) on the next business day will be disseminated upon receipt. The reported information will not be included in the calculation of the day's market aggregates.

[Adopted by SR-NASD-99-65 eff. July 1, 2002; amended by SR-NASD-2002-46 eff. July 1, 2002.]

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## **6260. Managing Underwriter Obligation To Obtain CUSIP**

(a) In order to facilitate trade reporting of secondary transactions in TRACE-eligible securities, the member that is the managing underwriter of any newly issued TRACE-eligible security must obtain and provide information to the TRACE Operations Center as required under paragraph (b). If a managing underwriter is not appointed, the group of underwriters must comply with paragraph (b).

(b) For such TRACE-eligible securities, the managing underwriter must provide to the TRACE Operations Center: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; and (6) a brief description of the issue (e.g., senior subordinated note, senior note), or if such information has not been determined, such other information as the NASD deems necessary. The managing underwriter must obtain the CUSIP number and provide it and the information listed as (2) through (6) not later than 5:00 p.m. on the business day preceding the day that the registration statement becomes effective, or, if registration is not required, the day before the securities will be priced. If an issuer notifies an underwriter, or the issuer and the underwriter determine, that the TRACE-eligible securities of the issuer shall be priced, offered and sold the same business day in an intra-day offering under Rule 415 of the Securities Act of 1933 or Rule 144A of the Securities Act of 1933, the member shall provide the information not later than 5:00 p.m. on the day that the securities are priced and offered, provided that if such securities are priced and offered on or after 5:00 p.m., the member shall provide the information not later than 5:00 p.m. on the next business day. A member must make a good faith determination that the security is a TRACE-eligible security before submitting the information to the TRACE Operations Center.

[Adopted by SR-NASD-99-65 eff. July 1, 2002; amended by SR-NASD-2002-46 eff. July 1, 2002.]

# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Continuing Education  
Legal and Compliance  
Registration  
Senior Management

## KEY TOPICS

Regulatory Element

## Regulatory Element

SEC Approves Rule Establishing New Registration Category for Proctors of In-Firm Delivery of the Regulatory Element

### Executive Summary

On September 24, 2002, the Securities and Exchange Commission (SEC) approved NASD Rule 1043, a new registration category for proctors of in-firm delivery of the Regulatory Element of NASD's continuing education requirements. The Rule permits registration by an associated person as a proctor without taking a qualification exam. A person may obtain designation as a proctor upon approval of an Application for Registration pursuant to Article V, Section 2 of NASD's By-Laws.

A person registered only as a proctor may not function in any other capacity that requires registration. However, the Rule does not prohibit a person who is registered with NASD in any other capacity from also serving as a proctor without being designated as such under the Rule.

Included with this *Notice* is Attachment A, the text of the rule.

Questions concerning this *Notice* should be directed to Philip Shaikun, Assistant General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8451.

### Background and Discussion

NASD Rule 1043 establishes a new registration category for proctors of in-firm delivery of the Regulatory Element of NASD's continuing education requirements. The Regulatory Element requires all registered persons to participate in a prescribed computer-based training session within 120 days of their second registration

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anniversary date and every three years thereafter. The Regulatory Element focuses on compliance, regulatory and ethical standards.

NASD Rule 1120(a)(6) permits each member to administer the Regulatory Element to their registered persons through a program delivered on the member's premises, provided that the member adheres to certain technology, administrative and regulatory standards. Among the requirements for in-firm delivery of the Regulatory Element is that the program sessions be proctored by an individual registered with a self-regulatory organization and supervised by a designated principal.

NASD believes the new registration category will make in-firm delivery a more attractive and efficient option for members while maintaining the integrity of the program. It will obviate the current need for members to either use a registered person who also has other day-to-day responsibilities or to commit resources needed to prepare a proctor for an exam-based registration.

Importantly, while the rule permits proctors to be registered without an exam, it still requires proctors to submit an application for registration in accordance with NASD By-Laws. As such, proctors will be required to file a Form U-4, which provides detailed employment and disciplinary history so that NASD can monitor the fitness of individuals to serve in that capacity. Any person whose sole registration is as a proctor under new NASD Rule 1043 will not be permitted to engage in any other activities requiring registration with NASD. The proposal will not prohibit a person who is registered with NASD in any other capacity from also serving as a proctor, as is permitted under existing rules.

## Effective Date

The Rule becomes effective on December 2, 2002. Members should note that Web CRD Release 4.2, which became available on October 21, 2002, contains an updated Form U-4 that includes a new category "IF" for the in-firm delivery proctor registration.

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## ATTACHMENT A

New language is underlined; deletions in brackets.

### **1040. Registration of Assistant Representatives [-Order Processing] and Proctors**

### **1041. Registration Requirements for Assistant Representatives**

(a) through (c) No change.

### **1042. Restrictions for Assistant Representatives**

(a) through (c) No change.

### **1043. Proctors of In-Firm Delivery of Regulatory Element**

(a) Any person associated with a member seeking to be designated as a Proctor under Rule 1120(a)(6)(E) for the purposes of in-firm delivery of the Regulatory Element shall be required to be registered pursuant to Rule 1120(a)(6)(E)(iii), but shall not be required to pass a Qualification Examination.

(b) Any person associated with a member may be designated as a Proctor upon approval of an Application for Registration pursuant to Article V, Section 2 of NASD's By-Laws. Any person whose sole registration is as a Proctor pursuant to this Rule 1043 shall not be qualified to function in any other area requiring registration with NASD.

(c) Nothing in this Rule 1043 shall prohibit a person who is registered with NASD in any other capacity from also serving as a Proctor without being designated as such under these provisions.

# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registration  
Senior Management

## KEY TOPICS

Compliance Programs  
Money Laundering

INFORMATIONAL

EFFECTIVE DATE: DECEMBER 31, 2002

## Anti-Money Laundering Compliance Programs

NASD Adopts Amendments to Rule 3011 to Require Members to Provide to NASD Contact Information for an Anti-Money Laundering Compliance Person(s)

### Executive Summary

NASD has adopted amendments to NASD Rule 3011 (Anti-Money Laundering Compliance Program) to require each member to provide to NASD contact information for the individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the member's anti-money laundering (AML) compliance program (AML Program) and to update the contact information as necessary. The rule change became effective immediately upon filing with the Securities and Exchange Commission on October 21, 2002 and will become operative on December 31, 2002. Attachment A contains the text of the amendments.

### Questions/Further Information

Questions regarding this *Notice to Members* may be directed to Grace Yeh, Assistant General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-6939.

### Discussion

The USA PATRIOT Act of 2001 (PATRIOT Act),<sup>1</sup> which was signed into law on October 26, 2001, recognizes that effective identification of money laundering and terrorist activities requires the expedited sharing and reporting of information among governmental and law enforcement authorities and financial institutions. In furtherance of this goal, Section 314(a) of the PATRIOT Act requires the Department of Treasury (Treasury) to adopt regulations to encourage cooperation and information sharing among financial institutions, their regulatory authorities, and law enforcement

02-78

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authorities. In particular, the regulations should be designed to facilitate law enforcement authorities' ability to share information with financial institutions and to request information from financial institutions about persons suspected of engaging in money laundering or terrorist activities. Section 314(a) further provides that the regulations adopted by Treasury may require that each financial institution designate one or more contact persons to receive information concerning, and to monitor accounts of, identified individuals or entities.

On September 18, 2002, Treasury issued a final rule implementing Section 314 of the PATRIOT Act. Consistent with Section 314(a), the rule creates a system for the efficient communication of potential money laundering and terrorist information. Upon receiving a request for information by the Financial Crimes Enforcement Network (FinCEN), a bureau of Treasury, the rule requires financial institutions to identify a contact person to handle the request and to receive future information requests. When requested by FinCEN, the financial institution is required to provide the name, title, mailing address, e-mail address, telephone number, and facsimile number of the designated contact person. The financial institution must also promptly notify FinCEN of any changes to the contact information.

NASD Rule 3011 requires each member to designate an individual or individuals responsible for implementing and monitoring the day-to-day operations of the firm's AML Program. To facilitate Treasury's efforts in collecting the AML contact information set forth in Treasury's final rule, NASD has amended Rule 3011 to require that members provide to NASD contact information concerning the members' designated AML compliance person(s). The information will be used by Treasury in connection with its regulatory obligations set forth in Section 314(a) of the PATRIOT Act and the implementing regulations promulgated thereunder. Consistent with Treasury's final rule, members will be required to provide to NASD the name, title, mailing address, e-mail address, telephone number, and facsimile number of the contact person. Members also will be required to promptly notify NASD of any changes to the information.<sup>2</sup> In addition, NASD anticipates requiring members periodically to review and confirm the accuracy of the contact information. Additional information will be provided in future.

NASD intends to initially collect the contact information through the Member Firm Contact Questionnaire on the NASD Web site. NASD anticipates that form and system changes necessary to collect the contact information will be completed by November 15, 2002. Members will have until December 31, 2002 to provide NASD with the necessary contact information.<sup>3</sup>

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## Endnotes

- 1 Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub. L. No. 107-56, 115 Stat. 272 (2001).
- 2 The amendments to Rule 3011 are consistent with New York Stock Exchange (NYSE) Rule 445 (AML Compliance Program) requirements that NYSE member organizations provide to the NYSE contact information identifying the member organization's designated AML compliance person and promptly notify the NYSE of any changes to the information.
- 3 New member applicants will be required to provide the contact information during the application process.

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## ATTACHMENT A

New language is underlined.

### 3011. Anti-Money Laundering Compliance Program

On or before April 24, 2002, each member shall develop and implement a written anti-money laundering program reasonably designed to achieve and monitor the member's compliance with the requirements of the Bank Secrecy Act (31 U.S.C. 5311, et seq.), and the implementing regulations promulgated thereunder by the Department of the Treasury. Each member organization's anti-money laundering program must be approved, in writing, by a member of senior management. The anti-money laundering programs required by this Rule shall, at a minimum,

(a) Establish and implement policies and procedures that can be reasonably expected to detect and cause the reporting of transactions required under 31 U.S.C. 5318(g) and the implementing regulations thereunder;

(b) Establish and implement policies, procedures, and internal controls reasonably designed to achieve compliance with the Bank Secrecy Act and the implementing regulations thereunder;

(c) Provide for independent testing for compliance to be conducted by member personnel or by a qualified outside party;

(d) Designate, and identify to NASD (by name, title, mailing address, e-mail address, telephone number, and facsimile number) an individual or individuals responsible for implementing and monitoring the day-to-day operations and internal controls of the program and provide prompt notification to NASD regarding any change in such designation(s); and

(e) Provide ongoing training for appropriate personnel.

# Notice to Members

NOVEMBER 2002

## SUGGESTED ROUTING

Executive Representatives

## Board Elections

NASD Notice of Meeting and Proxy

## KEY TOPICS

Board Elections

The Annual Meeting of Members of NASD will be held on December 5, 2002, at 11:00 am, at the NASD Visitors Center, 1735 K Street, NW, in Washington, DC. The purpose of the meeting is to conduct the election of Governors to the NASD Board. Members can raise other topics for discussion by properly notifying NASD of these topics.<sup>1</sup> The record date for the Annual Meeting is the close of business on November 1, 2002.

It is important that all members be represented at the Annual Meeting. Members are urged to vote in the election of Board members using one of the methods described below.

### Board of Governors Election

There are eight vacancies to be filled at this meeting—four Industry governorships, three Non-Industry governorships, and one Public governorship. The nominees for the vacancies are listed in Attachment A. The nominees elected will serve for terms specified in Attachment A.

Attachment B includes the biographies of the nominees of the NASD National Nominating Committee (NNC). Attachment C contains the names of the current Board of Governors.

### Voting Methods

Members will be able to vote using one of the following three methods:

- ♦ U.S. Mail
- ♦ Internet
- ♦ Phone

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The enclosed proxy contains detailed instructions on the voting procedures.

**Questions regarding this *Notice* may be directed to:**

Barbara Z. Sweeney  
NASD  
Office of the Corporate Secretary  
1735 K Street, NW  
Washington, DC 20006-1500

**Endnote**

- 1 Pursuant to Sections 1 and 3(b) of Article XXI of the NASD By-Laws, an NASD member may properly bring any other business before the Annual Meeting by giving timely notice in writing to the Secretary of NASD. In addition, the member must be an NASD member at the time of the delivery of such notice, and the other business must be a proper matter for member action. To be timely, a member's notice must be delivered to the Secretary at NASD's principal executive offices (the address is listed above) within 25 days of the date of this notice. The member's notice must offer a brief description of the other business, any material interest of the member in such business, and the reasons for conducting such business at the Annual Meeting.

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## ATTACHMENT A

### NASD Board of Governors Nominees

The following three persons have been nominated by the NNC to serve on the Board of Governors of NASD for a term of **one year**, or until NASDAQ is able to operate other than as a facility of NASD, whichever occurs first. These individuals currently serve simultaneously on the NASDAQ Board. Terms of office for all nominees who simultaneously serve on the NASDAQ Board run from December 5, 2002 to December 2003.

#### Terms of Office 2002-2003

##### INDUSTRY

Richard C. Romano	Chairman, Romano Brothers & Co.
Hardwick Simmons	Chairman and CEO, The NASDAQ Stock Market, Inc.

##### NON-INDUSTRY

H. Furlong Baldwin	Chairman, Mercantile Bankshares Corporation
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The following five persons have been nominated by the NNC to serve on the Board of Governors of NASD for a term of three years or until their successors are duly elected or qualified. Terms of office run from December 5, 2002 to December 2005.

#### Terms of Office 2002-2005

##### INDUSTRY

M. LaRae Bakerink	Chief Executive Officer, Westfield Bakerink Brozak, LLC
David A. DeMuro	Managing Director, Director of Global Compliance and Regulation, Lehman Brothers, Inc. (Representative of a National Retail Firm)

##### NON-INDUSTRY

John J. Brennan	Chairman and CEO, The Vanguard Group, Inc. (Representative of an Issuer of Investment Company Shares)
Eugene M. Isenberg	Chairman and CEO, Nabors Industries, Inc.

##### PUBLIC

Kenneth M. Duberstein	Chairman and CEO, The Duberstein Group, Inc.
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## ATTACHMENT B

### NASD Profiles of Board Nominees for Industry Governors

#### Industry

**M. LaRae Bakerink** is Chief Executive Officer of Westfield Bakerink Brozak, LLC. Ms. Bakerink currently serves on the Board of Directors and serves as President for the National Association of Independent Broker Dealers. Ms. Bakerink holds a B.S. and an M.B.A. from San Diego State University.

**David A. DeMuro** currently serves as Chair of the National Adjudicatory Council (2001-2002). He is Managing Director, Director of Global Compliance and Regulation at Lehman Brothers. Mr. DeMuro joined Lehman Brothers in 1984. Prior to that, he held various positions with the Securities and Exchange Commission in Detroit, Chicago, Los Angeles, and Washington, DC. Mr. DeMuro is a current member of the NASD Membership Committee and the NASD Licensing and Registration Council. He has been a member of the Executive Committee of the Securities Industry Association's Compliance and Legal Division and Chairman of the Securities Industry/Regulatory Council on Continuing Education. He currently serves on the NYSE's content committee for the Continuing Education Regulatory Element supervisor's program and the advisory board of *The Journal of Investment Compliance*, a publication of Institutional Investor, Inc. Mr. DeMuro is also a member of the Board of Trustees of the Theta Xi Fraternity Foundation. He holds a B.A. from the University of Michigan and a J.D. from the University of Notre Dame.

**Richard C. Romano** is Chairman of Romano Brothers & Company, having joined the firm in 1964. Mr. Romano has served on the Industry/Regulatory Council for Continuing Education, the NASD District Committee, and the NASD Board of Governors (1985-1988). Mr. Romano has also served on the NASD National Nominating Committee and the NASD Small Firm Advisory Board. He holds a B.S. from the University of Illinois and an M.S. and Ph.D. from the University of Delaware.

**Hardwick Simmons** is Chairman and Chief Executive Officer of The NASDAQ Stock Market, Inc. Mr. Simmons joined NASDAQ in February 2001 as Chief Executive Officer, and was elected Chairman of the Board on September 26, 2001, succeeding Frank G. Zarb. Prior to joining the company, Mr. Simmons served from May 1991 to December 2000 as President and Chief Executive Officer of Prudential Securities, Incorporated, the investment and brokerage firm. Prior to joining Prudential Securities in 1991, Mr. Simmons was President of the Private Client Group at Shearson Lehman Brothers, Inc. Mr. Simmons is a member and former Chairman of the Securities Industry Association, a former Director of the Chicago Board Options Exchange, and former President and current member of The Bond Club of New York, Inc. He is a Director and executive committee member of the New York City Partnership and serves on the Board of the National Academy Foundation. Mr. Simmons is President of the Board of Trustees of the Groton School and a trustee of the Rippowam Cisqua School in Mt. Kisco, New York. He has an A.B. from Harvard University, a M.B.A. from Harvard Business School, and served in the U.S. Marine Corps Reserve.

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## NASD Profiles of Board Nominees for Non-Industry Governors

### Non-Industry

**H. Furlong Baldwin** is Chairman of the Mercantile Bankshares Corporation. Mr. Baldwin joined Mercantile-Safe Deposit & Trust Company in 1956 and was elected President in 1970 of Mercantile-Safe Deposit & Trust Company and Mercantile Bankshares Corporation, and served as CEO from 1976 - 2001. Mr. Baldwin serves on the Boards of W. R. Grace & Company, Wills Group, and NASDAQ. Mr. Baldwin graduated from Princeton University and served on active duty with the U.S. Marine Corps.

**John J. Brennan** is Chairman and Chief Executive Officer and a member of the Board of Directors of each of the mutual funds in the Vanguard Group. Mr. Brennan joined Vanguard in July 1982. He was elected President in 1989, Chief Executive Officer in 1996, and Chairman of the Board in 1998. Prior to his career at Vanguard, Mr. Brennan had been employed at S.C. Johnson & Son in Racine, Wisconsin and the New York Bank of Savings. Mr. Brennan is the past Chairman of the Investment Company Institute and is a Trustee of the Financial Accounting Foundation. He graduated from Dartmouth College in 1976 with an A.B. degree, and received an M.B.A. from the Harvard Business School in 1980.

**Eugene M. Isenberg** is Chairman and Chief Executive Officer of Nabors Industries, Inc., a position he has held since 1987. He serves as a Director of the American Stock Exchange and also Danielson Holding Corporation, an insurance holding company. Mr. Isenberg is also a member of the National Petroleum Council, which is an advisory panel to the United States Department of Energy. From 1969 to 1982, Mr. Isenberg was Chairman of the Board and principal shareholder of Genimar, Inc., a steel trading and building products manufacturing company, which was sold in 1982. From 1955 to 1968, Mr. Isenberg was employed in various management capacities with the Exxon Corporation. Mr. Isenberg is the founder and principal sponsor of the Parkside School for children with learning disabilities and has established the Eugene M. Isenberg Scholarships at the University of Massachusetts where the School of Management is named after him. He was an instructor at Princeton University from 1951 to 1952 and served as an officer in the U.S. Navy from 1952 to 1955. Mr. Isenberg holds a B.A. from the University of Massachusetts and an M.A. from Princeton University in 1952. Mr. Isenberg completed the program for Senior Executives at M.I.T.

## NASD Profile of Board Nominee for Public Governor

### Public

**Kenneth M. Duberstein** is Chairman and Chief Executive Officer of The Duberstein Group. Prior to this, Mr. Duberstein served as Chief of Staff to President Ronald Reagan from 1988 to 1989. During President Reagan's two terms in office, Mr. Duberstein also served in the White House as Deputy Chief of Staff (1987), as well as both the Assistant and the Deputy Assistant to the President for Legislative Affairs (1981 to 1983). Mr. Duberstein currently serves on the Board of Governors of the American Stock Exchange and on the Board of Directors of Boeing Company, Conoco, Fannie Mae, Fleming, and The St. Paul Companies, Inc. He is Vice Chairman of the Kennedy Center for the Performing Arts. Mr. Duberstein holds an A.B. from Franklin and Marshall College and an M.A. from American University.

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## ATTACHMENT C

### Current Board of Governors Governors with Terms Expiring in 2002

#### Industry

M. LaRae Bakerink	Chief Executive Officer, Westfield Bakerink Brozak, LLC
David A. DeMuro	Managing Director, Director of Global Compliance and Regulation, Lehman Brothers, Inc.
Richard C. Romano	Chairman, Romano Brothers & Co.
Hardwick Simmons	Chairman and CEO, The NASDAQ Stock Market, Inc.

#### Non-Industry

H. Furlong Baldwin	Chairman, Mercantile Bankshares Corporation
Eugene M. Isenberg	Chairman and CEO, Nabors Industries, Inc.
James F. Rothenberg*	President, Capital Research and Management Company

#### Public

Kenneth M. Duberstein	Chairman and CEO, The Duberstein Group, Inc.
Donald J. Kirk*	
John D. Markese*	President, American Association of Individual Investors

\* Not eligible for re-election

### Governors with Terms Expiring in 2003

#### Industry

William C. Alsover, Jr.	Chairman, Centennial Securities Company, Inc.
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#### Non-Industry

Arvind Sodhani*	Vice President and Treasurer, Intel Corporation
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#### Public

Brian T. Borders, Esq.	Mayer, Brown, Rowe & Maw
Sharon P. Smith	Dean, College of Business Administration, Fordham University

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## Governors with Terms Expiring in 2004

### Industry

John W. Bachmann	Managing Partner, Edward D. Jones & Company
Richard F. Brueckner	Chief Operating Officer, Pershing Division of Credit Suisse First Boston
Raymond A. Mason	Chairman & CEO, Legg Mason Wood Walker, Inc.

### Non-Industry

Harry P. Kamen*	Retired Chairman and Chief Executive Officer, Metropolitan Life Insurance Company
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### Public

James E. Burton	Chief Executive Officer, California Public Employees' Retirement System
Sir Brian Corby	Chairman (retired), Prudential Assurance Company
James R. Rutherford, Jr.	President and CEO, Moody's Corporation

\* Not eligible for re-election

# Disciplinary Actions

## REPORTED FOR NOVEMBER

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of October 2002.

### Firm Fined, Individual Sanctioned

Blake Street Securities, LLC (CRD #44905, Denver, Colorado) and Brad Allen Dowell (CRD #1308189, Registered Principal, Denver, Colorado) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Dowell was fined \$2,500 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that they failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with Section 17(b) of the Securities Act of 1933 and NASD Conduct Rule 2210(b). The findings stated that the firm and Dowell failed to conduct the required reviews, and thereby failed to prevent a registered representative of the firm from publishing information about stocks on his Web site without fully disclosing the amounts of compensation he received for doing so.

Dowell's suspension began November 4, 2002, and will conclude at the close of business November 8, 2002. (NASD Case #CMS020171)

### Firms and Individuals Fined

CyBerBroker, Inc. n/k/a CyberTrader, Inc. (CRD #44523, Austin, Texas), and Mark Kurt Stryker (CRD #2740097, Registered Principal, Austin, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which they were each censured and fined \$15,000. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm placed an advertisement on its Web site and on the Web sites of other parties that said it was the "#1 Electronic Broker For Active Online Traders" and included a disclaimer that the statement was based on "industry research" conducted by an independent financial services firm when, in fact, the firm internally utilized a different analysis to determine that it was the highest-ranked firm and failed to disclose in its communications with the public its analysis or the basis for its determination, causing the statement to be misleading. The findings also stated that Stryker conceived and approved the internal analysis done by the firm and approved the "global" use of the phrase, providing the firm's compliance staff with evidence sufficient to support the statement. (NASD Case #CAF020040)

**PCI\* Trade Securities (CRD #40650, Fremont, California) and Shixiong Liu (CRD #2217632, Registered Principal, Fremont, California)** submitted an Offer of Settlement in which they were censured and fined \$11,454.46, jointly and severally. The fine included disgorgement of \$3,954.46 in commissions paid to Liu. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Liu performed activities as a registered person and performed duties in a capacity requiring registration, and the firm permitted him to perform such activities, duties, and functions, when Liu was deemed inactive for failure to complete the Regulatory Element of Continuing Education. NASD found that the firm, acting through Liu, failed to comply with the Firm Element of the Continuing Education Requirement for the firm's covered personnel in that it failed to perform a written needs analysis and create a written training plan as set forth in NASD Membership and Registration Rule 1120(b). **(NASD Case #C01020010)**

## **Firms Fined**

**ABN AMRO Incorporated (CRD #15776, Chicago, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to take reasonable steps to ensure that the executing brokers clearing trades through the firm completely and accurately reported transactions in municipal securities effected with other broker/dealers or municipal securities dealers. NASD also found that the firm failed to provide accurate and timely information regarding municipal securities trades to the National Securities Clearing Corporation (NSCC), which caused the firm's T-Input Percentage to be consistently below the industry average. **(NASD Case #C8A020065)**

**Allmerica Investments, Inc. (CRD #3960, Worcester, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$30,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to establish an adequate supervisory system reasonably designed to prevent and detect unsuitable mutual fund transactions in customer accounts. The findings also stated that the firm failed to establish reasonable written supervisory procedures for identifying the process the firm used in reviewing and detecting unsuitable mutual fund transactions, and to the extent the firm had written supervisory procedures related to mutual fund transactions, the firm failed to take steps to ensure that the procedures were followed. **(NASD Case #C11020036)**

**Conseco Equity Sales, Inc. (CRD #4125, Carmel, Indiana)** submitted a Letter of Acceptance, Waiver, and Consent in which

the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it allowed representatives to act in a capacity requiring registration without being so registered due to a failure to complete the Regulatory Element of Continuing Education. The findings also stated that the firm failed to establish, maintain, and enforce written supervisory procedures to ensure compliance with the Regulatory Element of Continuing Education. **(NASD Case #C8A020073)**

**First Institutional Securities, LLC (CRD #23910, West Paterson, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$15,000, and required to pay \$1,840 in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it incorrectly reported to the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) the capacity in which it had acted and failed to report trades properly. The findings also stated that the firm failed to display immediately customer limit orders in its public quotation when each such order was at a price that would have improved the firm's bid or offer in each such security, and failed to contemporaneously or partially execute customer limit orders after it traded each subject security for its own market-making account at a price that would have satisfied each customer's limit order. In addition, NASD found that the firm incorrectly notified a customer that the trade had been executed on an agency basis, when, in fact, the trade had been effected on a principal basis and failed to maintain an order ticket for transactions and the order tickets failed to reflect the correct execution or entry time. **(NASD Cases #C9B020072 and C9B020073)**

**First Montauk Securities Corp. (CRD #13755, Red Bank, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to display immediately customer limit orders in NASDAQ securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer in such security, and the size of the order represented more than a de minimis change in relation to the size associated with its bid or offer in each such security. The findings also stated that the firm failed to report to the Fixed Income Pricing System<sup>SM</sup> (FIPS<sup>SM</sup>) transactions in FIPS securities within five minutes after execution. **(NASD Case #CMS020178)**

**KBC Financial Products USA, Inc. (CRD #46709, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to

transmit through ACT last-sale reports of transactions in NASDAQ National Market<sup>®</sup> (NNM<sup>®</sup>), NASDAQ SmallCap<sup>SM</sup> (SC<sup>SM</sup>), and Consolidated Quotation Service (CQS) securities. NASD also found that the firm incorrectly designated as “.SLD” through ACT last-sale reports of transactions in NNM securities and CQS securities reported to ACT within 90 seconds of execution. The findings stated that the firm failed to accept or decline in ACT transactions in eligible securities within 20 minutes after execution. (NASD Case #CMS020163)

**Northeast Securities, Inc. (CRD #25996, Mitchelfield, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, during the contingency period of a private placement offering in which the firm served as placement agent for a best efforts “part-or-none” private placement self-offering of interests in the firm, it failed to ensure that the money or other considerations received were promptly transferred to a bank that had agreed in writing to hold all such funds in escrow for the persons who had the beneficial interests therein, and to transmit or return such funds directly to the persons entitled thereto when the appropriate event or contingency had occurred. (NASD Case #CLI020008)

**Spencer Trask Ventures, Inc. (CRD #28373, New York, New York)** was censured and fined \$41,636, of which \$1,000 was jointly and severally. The sanctions were based on findings that the firm, in violation of the Free-Riding Withholding Interpretation, sold “hot issues” to prohibited accounts and failed to exercise reasonable supervision and to establish and maintain supervisory procedures reasonably designed to achieve compliance with NASD Rule IM-2110-1. (NASD Case #C8A020010)

**SWS Securities, Inc. f/k/a Southwest Securities, Inc. (CRD #6220, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$25,000, and required to revise its written supervisory procedures as they relate to the review of approval of letters of authorization and the firm’s credit restrictions and trading parameters. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to enforce written supervisory procedures addressing the handling, approval, and processing of customer letters of authorization (LOA) received from its correspondent firms participating in day-trading activities. The findings also stated that the firm failed to reflect in its written supervisory procedures its procedures to address the setting of trading parameters for correspondent firms and the monitoring of correspondent transactions away from the firm. (NASD Case #C05020047)

**Worldco, L.L.C. (CRD #24673, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described

sanctions and to the entry of findings that it reported proprietary and customer short-sale transactions through ACT without a short-sale modifier, and long-sale transactions were incorrectly reported as short. The findings also stated that the firm executed proprietary short-sale transactions in NASDAQ National Market Securities (NMS) at the current inside bid, when the current inside bid was below the preceding inside bid in the security. (NASD Case #C05020049)

## Individuals Barred or Suspended

**Richard Ralph Avis (CRD #2490874, Registered Representative, Tampa, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, including disgorgement of earned commissions of \$7,560, and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Avis consented to the described sanctions and to the entry of findings that he participated in an outside business activity for compensation without providing prompt written notice to his member firm.

Avis’ suspension began November 4, 2002, and will conclude May 3, 2003. (NASD Case #C07020074)

**Michael Baldo a/k/a Miguel Baldo Lozano (CRD #2620455, Registered Representative, Long Island City, New York)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the allegations, Baldo consented to the described sanctions and to the entry of findings that he effected transactions in the accounts of public customers without their prior knowledge, authorization, or consent.

Baldo’s suspension began October 21, 2002, and will conclude at the close of business January 20, 2003. (NASD Case #C10020062)

**Donald Jeffrey Barker (CRD #4476980, Associated Person, Aurora, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured, fined \$2,500, and suspended from association with any NASD member in any capacity for nine months. The fine must be paid before Barker reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Barker consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Uniform Application for Securities Industry Registration or Transfer (Form U-4).

Barker’s suspension began October 21, 2002, and will conclude July 20, 2003. (NASD Case #C8A020069)

**Bruce Douglas Berry (CRD #2846046, Registered Representative, Livonia, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Berry consented to the described sanctions and to the entry of findings that he removed an IRA rollover check that a public customer submitted to his office, brought the check to the customer's home, and suggested that the customer transfer the rollover to a company affiliated with his soon-to-be new employer. The findings also stated that after the customer completed a new account form, Berry crossed out and substituted the payee on the rollover check, placed the customer's initials next to the payee line, and submitted the check to the new company, but the check was rejected.

Berry's suspension began November 4, 2002, and will conclude at the close of business December 3, 2002. (NASD Case #C8A020063)

**Douglas Scott Bingaman (CRD #1611958, Registered Representative, South Bend, Indiana)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Bingaman consented to the described sanction and to the entry of findings that he received \$37,553 from public customers for investments, deposited the funds into his own account, and then converted the funds to his own use without the knowledge or consent of the customers. (NASD Case #C8A020066)

**Anthony Brian John Black (CRD #1582391, Registered Supervisor, San Diego, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Black consented to the described sanction and to the entry of findings that, without public customers' knowledge or consent, he affixed the customers' and other necessary signatures on multiple letters of authorization (LOAs), withdrew \$140,000 in customer funds from a variable annuity contract, transferred these funds to a bank account under his ownership and control, and used the funds for his personal use. (NASD Case #C02020051)

**Ronald James Blekicki (CRD #2615061, Registered Representative, Boulder, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Blekicki reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Blekicki consented to the described sanctions and to the entry of findings that he failed to disclose fully the amounts of compensation he received in exchange for publishing favorable information about stocks on

his Internet Web site. The findings also stated that Blekicki failed to have a registered principal of his member firm review and pre-approve his Internet publications. In addition, NASD found that Blekicki maintained a securities account at another broker/dealer without notifying his member firm, and without notifying the firm where the account was opened when he became associated with another member firm.

Blekicki's suspension began November 4, 2002, and will conclude at the close of business November 3, 2003. (NASD Case #CMS020170)

**Robert Loal Boeke, Sr. (CRD #2515281, Registered Representative, Rockford, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$43,000, including the disgorgement of financial benefits received, and barred from association with any NASD member in any capacity. The fine must be paid before Boeke reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Boeke consented to the described sanctions and to the entry of findings that he converted a public customer's funds totaling \$100,000 to his own use and deposited the funds into his personal brokerage account held at another member firm without the knowledge or consent of the customer. The findings also stated that Boeke failed to disclose to his member firm that he maintained a brokerage account at another member firm. (NASD Case #C8A020067)

**Jason Phillip Bronston (CRD #2635605, Registered Representative, West Hills, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Bronston consented to the described sanction and to the entry of findings that he received and converted \$77,000 in customer funds intended for investment purposes. The findings also stated that Bronston failed to respond to NASD requests for information. (NASD Case #C02020047)

**Paul Raymond Brunner (CRD #3178981, Registered Representative, O'Fallon, Missouri)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, including \$5,000, plus interest, in disgorgement of commissions to customers, and suspended from association with any NASD member in any capacity for 60 days. The fine and disgorgement must be paid before Brunner reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Brunner consented to the described sanctions and to the entry of findings that he engaged in private securities transactions away from his member firm and failed to provide his firm with detailed written notice of the transactions and his role therein, and to receive permission from his member firm to engage in the transactions. The findings also

stated that Brunner acted in capacities requiring registration as a general securities representative without being properly registered with NASD.

Brunner's suspension began November 4, 2002, and will conclude at the close of business January 2, 2003. (NASD Case #C04020034)

**Harvey Lee Bunker, Jr. (CRD #3015864, Registered Representative, Nashville, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Bunker reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Bunker consented to the described sanctions and to the entry of findings that he misappropriated \$11,974 in insurance premium payments that he received from public customers of his member firm by borrowing such funds to meet his business expenses, without the knowledge or the express or implied consent of the customers or his member firm.

Bunker's suspension began October 21, 2002, and will conclude at the close of business October 20, 2003. (NASD Case #C8A020070)

**Salvatore Carrizzo, Jr. (CRD #2276381, Registered Representative, Massapequa Park, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for one year. In light of the financial status of Carrizzo, no monetary sanctions have been imposed. Without admitting or denying the allegations, Carrizzo consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm.

Carrizzo's suspension began October 21, 2002, and will conclude at the close of business October 20, 2003. (NASD Case #C9B020067)

**Timothy Roderick Chamberlain (CRD #2693994, Registered Principal, Costa Mesa, California)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. In light of the financial status of Chamberlain, no monetary sanctions have been imposed. Without admitting or denying the allegations, Chamberlain consented to the described sanction and to the entry of findings that he participated in a scheme to manipulate the share price of a common stock in exchange for guaranteed profits for stocks that he bought and sold at the direction of two individuals. The findings stated that Chamberlain also accepted compensation in the form of shares of stock, which he received in nominee accounts. In addition, the findings stated that Chamberlain failed to notify his member firm and the executing member firm at which he traded his shares of stock, in writing, of his association with the other member firm prior to opening

his trading account or placing an initial order for the purchase or sale of sales of stock. (NASD Case #CAF010021)

**Brian Francis Colby (CRD #1896649, Registered Representative, Boston, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Colby consented to the described sanction and to the entry of findings that he engaged in Free-Riding by purchasing shares in the "hot issue" offerings (where shares traded at a premium in the aftermarket) through the account of a public customer while registered with his member firm. The findings also stated that Colby provided false and/or misleading responses to NASD during an on-the-record interview. (NASD Case #C9B020064)

**Jeffrey Paul Couper (CRD #1111013, Registered Representative, Iron Mountain, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Couper reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Couper consented to the described sanctions and to the entry of findings that he mishandled customer funds when he accepted and held monthly cash payments intended for life insurance premiums from a public customer. NASD found that the funds were not applied to the insurance policies, and, as a result, the policies lapsed. The findings also stated that Couper mishandled public customer funds when he accepted \$135 from the customer for payment of a variable life product, but failed to promptly apply the funds to the product.

Couper's suspension began November 4, 2002, and will conclude May 3, 2003. (NASD Case #C8A020045)

**Lucretia Pamela Davis (CRD #3276421, Registered Representative, Columbus, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Davis consented to the described sanction and to the entry of findings that she forged the signatures of members of the public on savings account withdrawal slips for accounts maintained at a bank affiliate of her member firm, presented the withdrawal slips, obtained proceeds totaling \$41,700, and used the proceeds for her own benefit, without their knowledge, consent, or authorization. (NASD Case #C8B020019)

**Marlon Francisco Delgado (CRD #2531325, Registered Representative, Franklin Square, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member in any capacity for 18 months, and required to requalify by exam as a general securities representative. If Delgado fails to requalify within 60 days after conclusion of the suspension, he

shall not associate with any NASD member in any capacity until he requalifies. The fine must be paid before Delgado reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Delgado consented to the described sanctions and to the entry of findings that he effected the sale of securities in at least three states in which he was not yet registered, and attempted to conceal it by placing the trades under another broker's name. The findings stated that Delgado solicited public customers to purchase securities, downplayed the attendant investment risks, and made unwarranted price predictions, causing the customers to authorize and pay for the transactions. NASD also found that Delgado effected transactions in the account of a public customer without the customer's prior knowledge, authorization, or consent.

Delgado's suspension began October 21, 2002, and will conclude at the close of business April 20, 2004. (NASD Case #C10020093)

**Donald Francis Dupont (CRD #2581848, Registered Representative, Averill Park, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Dupont reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Dupont consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts by failing to amend his Form U-4.

Dupont's suspension began November 4, 2002, and will conclude May 3, 2003. (NASD Case #C11020040)

**Walter William Durchhalter (CRD #1428989, Registered Principal, Middle Village, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$25,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Durchhalter reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Durchhalter consented to the described sanctions and to the entry of findings that, as head trader of his member firm, he caused his firm to bid for, purchase, and induce others to purchase warrants while the firm was engaged in a distribution of the warrants. The findings stated that Durchhalter posted the firm's bid and ask price quotations at prices intended to induce others to purchase warrants from, and sell warrants to, his member firm in the aftermarket during these periods and executed purchases of warrants on behalf of his member firm.

Durchhalter's suspension began October 21, 2002, and will conclude at the close of business October 20, 2003. (NASD Case #CAF020034)

**Nancy Katherine Evans (CRD #2422682, Registered Representative, Marshfield, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Evans consented to the described sanction and to the entry of findings that, without the knowledge or consent of a public customer, she prepared and signed the customer's signature on Letters of Authorization that authorized wire transfers totaling \$24,254.13 from the customer's account, which were misappropriated by Evans for her own personal use. (NASD Case #C11020038)

**Kevin Thomas Ferguson (CRD #4143905, Registered Representative, Boston, Massachusetts)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Ferguson issued annuitant checks totaling \$26,040 without the consent or authorization of the annuitants, and converted the funds to his own use and benefit. In addition, Ferguson failed to respond to NASD requests for information. (NASD Case #C11020017)

**Gary Andrew Finly (CRD #2776637, Registered Representative, North Port, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Finly consented to the described sanction and to the entry of findings that, without authorization or consent, he forged the signatures of public customers on account transfer paperwork in order to cause their accounts to be transferred from his former member firm to his new member firm. (NASD Case #C07020072)

**Frederic James Folino (CRD #1210850, Registered Representative, Camarillo, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, ordered to disgorge \$22,200 in commissions received to be paid as restitution to public customers, and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the allegations, Folino consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing prior written notice to his member firm.

Folino's suspension began October 21, 2002, and will conclude at the close of business January 20, 2003. (NASD Case #C06020014)

**William Walton Glauser (CRD #3250733, Registered Representative, Huntsville, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 18 months. The fine must be paid before Glauser reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Glauser consented to the described sanctions and to the entry of findings that, in connection with a Series 65 examination, he

committed an act of misconduct by removing scratch paper from the test center without authorization, and, as a result, his testing session was terminated. The findings also stated that Glauser willfully failed to disclose material facts on his Form U-4.

Glauser's suspension began October 21, 2002, and will conclude at the close of business April 20, 2004. (NASD Case #C06020012)

**David William Haburjak (CRD #2233093, Registered Representative, W. Gastonia, North Carolina)** was fined \$10,000 and suspended from association with any NASD member in any capacity for 20 business days. The sanctions are based on findings that Haburjak exercised discretionary power in the accounts of public customers without written discretionary authority from the customers or his member firm's acceptance of the accounts as discretionary.

Haburjak's suspension began October 7, 2002, and concluded at the close of business November 1, 2002. (NASD Case #C07010100)

**Peter Van Hamm (CRD #2530393, Registered Representative, Dunellen, New Jersey)** was fined \$25,000 and suspended from association with any NASD member in any capacity for one year. The fine is due and payable upon Hamm's re-entry into the securities industry. The sanctions are based on findings that Hamm executed unauthorized transactions in the accounts of public customers.

Hamm's suspension began November 4, 2002, and will conclude at the close of business November 3, 2003. (NASD Case #C10010082)

**Glen S. Hancock (CRD #1461959, Registered Representative, Cedar Park, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, ordered to pay \$4,875, plus interest, in restitution to public customers, and suspended from association with any NASD member in any capacity for 30 business days. Without admitting or denying the allegations, Hancock consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing prior written notice to his member firm.

Hancock's suspension began November 4, 2002, and will conclude at the close of business December 16, 2002. (NASD Case #C05020048)

**Kevin Jay Hayes (CRD #4435512, Associated Person, St. Louis, Missouri)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Hayes failed to respond to NASD requests for information. Hayes also failed to disclose a material fact on his Form U-4. (NASD Case #C04020014)

**Herbert Clarence Hearne (CRD #2462835, Registered Principal, Cotuit, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for one month. The fine must be paid before Hearne reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hearne consented to the described sanctions and to the entry of findings that he agreed to process the paperwork to open accounts and purchase transactions, effect the transactions, and pay the commissions to a registered representative of another member firm once the representative became registered with his member firm. NASD found that Hearne paid the representative commissions for transactions that occurred prior to the representative becoming registered with his member firm. In addition, NASD determined that Hearne failed to take appropriate action to supervise a registered representative who recommended unsuitable transactions in customer accounts, which was reasonably designed to prevent the violations by the representative and achieve compliance with applicable securities laws, regulations, and NASD rules.

Hearne's suspension began October 21, 2002, and will conclude at the close of business November 20, 2002. (NASD Case #C11020035)

**Wayne William Hoffman (CRD #1097848, Registered Principal, Fogelsville, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hoffman consented to the described sanction and to the entry of findings that he participated in private securities transactions outside the scope of his employment with his member firm and failed to provide prior written notice of his proposed participation in the transactions to his member firm. (NASD Case #C9A020042)

**John Allen Jones, IV (CRD #2351720, Registered Representative, Montgomery, Alabama)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for one year. Without admitting or denying the allegations, Jones consented to the described sanction and to the entry of findings that he recommended purchase and sale transactions in various securities to public customers without having reasonable grounds for believing that they were suitable for the customers in view of the frequency and nature of the recommended transactions and the customers' financial situation, objectives, circumstances, and needs.

Jones' suspension began November 4, 2002, and will conclude at the close of business November 3, 2003. (NASD Case #C05020006)

**Eugene Michael Kingman (CRD #1995746, Registered Representative, Holmdel, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Kingman reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Kingman consented to the described sanctions and to the entry of findings that in sworn testimony before NASD, he falsely testified that presented order tickets represented actual orders for stock and later admitted that he had given false testimony.

Kingman's suspension began October 21, 2002, and will conclude April 20, 2003. (NASD Case #CMS020165)

**William Francis Kirincich (CRD #1388826, Registered Principal, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any principal or supervisory capacity for 30 days. The fine must be paid before Kirincich reassociates with any NASD member. Without admitting or denying the allegations, Kirincich consented to the described sanctions and to the entry of findings that he permitted persons associated with his member firm to engage in the securities business of the firm as general securities representatives and/or assistant representatives—order processing while they were not registered with the NASD in any capacity.

Kirincich's suspension began October 7, 2002, and concluded at the close of business November 5, 2002. (NASD Case #C10020097)

**Gary Charles Klein (CRD #1731164, Registered Representative, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Klein consented to the described sanction and to the entry of findings that he opened, or caused to be opened, a securities brokerage account at another member firm and executed transactions in the account without providing written notification to his member firm of his intentions to execute these transactions, and failed to advise the other firm of his association with his member firm. The findings stated that Klein opened the account pursuant to an oral understanding he had with a public customer at his firm through which Klein and the customer agreed to treat the account as a partnership account and that they would share equally in any profits in the account. NASD found that Klein opened the account in his name only and never received written authorization from the firm to share in the profits in the account with the customer. The findings also stated that Klein exercised discretionary authority in the account by executing all equity transactions without obtaining the customer's prior written

authorization and his member firm's written acceptance of the account as discretionary. In addition, NASD found that Klein received \$68,032.83 in customer funds intended to be deposited in the account, did not apply all the funds as directed by the customer, and instead, without the customer's knowledge or consent, misused \$4,532.82, which he did not deposit until after six months of receipt. (NASD Case #C02020043)

**Lawrence John LaSala (CRD #2237835, Registered Representative, Oak Ridge, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, LaSala consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm. (NASD Case #C9B020065)

**Christopher John Lester (CRD #2875370, Registered Representative, Somerset, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for two years. In light of the financial status of Lester, no monetary sanctions have been imposed. Without admitting or denying the allegations, Lester consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm.

Lester's suspension began October 21, 2002, and will conclude at the close of business October 20, 2004. (NASD Case #C9B020066)

**Troy Anthony Litle (CRD #1364827, Registered Representative, Fresno, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Litle consented to the described sanctions and to the entry of findings that, without prior approval of his member firm, he distributed sales literature in the form of a letter to public customers concerning a variable annuity that was an incomplete description of the product's features and therefore contained unwarranted, exaggerated, and misleading statements.

Litle's suspension is deemed served based on a suspension imposed by his member firm. (NASD Case #C01020015)

**James Lopresti (CRD #3236682, Associated Person, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Lopresti reassociates with any NASD member following the suspension or before requesting

relief from any statutory disqualification. Without admitting or denying the allegations, Lopresti consented to the described sanctions and to the entry of findings that he failed to respond timely to NASD request for information.

Lopresti's suspension began October 21, 2002, and will conclude at the close of business October 20, 2003. (NASD Case #C9B020061)

**Tina Sue Lounsbury (CRD #2817864, Registered Principal, Jacksonville, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Lounsbury consented to the described sanction and to the entry of findings that she obtained \$105,430.67 from the accounts of public customers, without their authorization or consent, and used the funds for her own purposes. The findings also stated that Lounsbury failed to respond to NASD requests for information. (NASD Case #C07020076)

**Richard Scott Madden (CRD #2112496, Registered Representative, Houston, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Madden consented to the described sanction and to the entry of findings that he changed the addresses for joint accounts belonging to public customers to that of a third party and effected transactions in the accounts without the customers' authorization, knowledge, or consent. In addition, NASD found that Madden sent the customers computer-generated reports that contained some information about the account but failed to reflect any of Madden's unauthorized trading activity. The findings also stated that Madden failed to respond to NASD requests for information. (NASD Case #C06020013)

**Imran A. Maniar (CRD #2953812, Registered Representative, Houston, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 15 days. The fine must be paid before Maniar reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Maniar consented to the described sanctions and to the entry of findings that he exercised discretionary transactions in the account of a public customer without having obtained prior written authorization from the customer and written acceptance of the account as discretionary by his member firm.

Maniar's suspension began November 4, 2002, and will conclude at the close of business November 18, 2002. (NASD Case #C05020050)

**Consuelo Velasco Marcelino (CRD #2832189, Registered Representative, Glendale, California)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Marcelino reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Marcelino consented to the described sanctions and to the entry of findings that, in an attempt to expedite the opening of a public customer's account, she affixed the customer's signature on a new account application without the customer's knowledge or consent.

Marcelino's suspension began November 4, 2002, and will conclude at the close of business December 3, 2002. (NASD Case #C02020050)

**Ken Marks (CRD #2192323, Registered Representative, Jersey City, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for eight weeks. The fine must be paid before Marks reassociates with any NASD member following the suspension. Without admitting or denying the allegations, Marks consented to the described sanctions and to the entry of findings that he sent, 19 seconds prior to the close of normal business hours, a SelectNet® order to buy shares from another firm, causing his member firm to send the order without first accessing the inside market. The findings also stated that when Marks sent the SelectNet order to purchase shares, he caused the last trade price of shares to be artificially increased, and as a result, he was able to sell the orders at an advantageous price gain.

Marks' suspension began October 21, 2002, and will conclude at the close of business December 13, 2002. (NASD Case #CMS020162)

**Amy Lynn Martin (CRD #3204695, Registered Representative, Memphis, Tennessee)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Martin transferred \$128,000 from the accounts of public customers to the checking account of another public customer. The transfer of funds was done for a purpose not directed by the customers and without their knowledge or consent. (NASD Case #C05020018)

**Wayne Paul Messner (CRD #2170398, Registered Representative, St. Charles, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Messner consented to the described sanction and to the entry of findings that he received a \$5,000 check from a public customer for the purpose of investing in mutual funds. NASD found that Messner then deposited the check into his business checking account and converted the funds to his own use or for some purpose other

than the benefit of the customer without the knowledge or consent of the customer. The findings also stated that Messner failed to respond completely to NASD requests for information. (NASD Case #C8A020072)

**Aaron Simon Morris (CRD #2691021, Registered Representative, Hollywood, Florida)** was fined \$45,313, suspended from association with any NASD member in any capacity for nine months, and required to pay \$22,668, plus interest, in restitution to public customers. The sanctions were based on findings that Morris made fraudulent omissions of material fact in connection with the offer and sale of a security.

Morris' suspension began October 7, 2002, and will conclude at the close of business July 7, 2003. (NASD Case #C3A020006)

**James Steven Neumeier (CRD #2097359, Registered Representative, High Ridge, Missouri)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Neumeier consented to the described sanction and to the entry of findings that, without the knowledge or consent of a public customer, he caused a \$25,000 loan to be made from the customer's fixed insurance contract, instructed the customer to deposit the check into his personal checking account, and to write Neumeier a personal check payable to him for \$25,000. NASD found that Neumeier represented to the customer that he would repay his member firm with his funds and instead of repaying, he endorsed and deposited the check into an account under his control, thereby converting the funds to his own use and benefit. The findings also stated that Neumeier failed to respond completely to NASD requests for information. (NASD Case #C04020033)

**Bryan Dominic Orjuela (CRD #1865605, Registered Representative, Long Beach, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for one year. Without admitting or denying the allegations, Orjuela consented to the described sanction and to the entry of findings that in sworn testimony before NASD, he falsely testified that presented order tickets represented actual orders for stock and admitted that he had given false testimony.

Orjuela's suspension began October 21, 2002, and will conclude at the close of business October 20, 2003. (NASD Case #CMS020164)

**Leland Keith Ozawa, Jr. (CRD #2119830, Registered Representative, Las Vegas, Nevada)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for two months. Without admitting or denying the allegations, Ozawa consented to the described sanctions and to

the entry of findings that he participated in private securities transactions without providing prior written notice to, and receiving written approval from, his member firm.

Ozawa's suspension began October 21, 2002, and will conclude at the close of business December 20, 2002. (NASD Case #C02020046)

**Joseph John Papeo (CRD #2476778, Registered Representative, Brooklyn, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Papeo consented to the described sanction and to the entry of findings that he effected transactions in the accounts of public customers without their prior knowledge, authorization, or consent. The findings also stated that Papeo, in an exercise of discretion, effected transactions in the joint account of public customers without their prior written authorization and his member firm's written acceptance of the account as discretionary. In addition, NASD found that Papeo exercised discretion in the account of public customers and effected a purchase transaction without having reasonable grounds for believing that the transaction was reasonable based on the customers' financial situation, investment objectives, and financial needs. NASD also found that Papeo effected transactions in his joint trading account at his member firm without paying for the transactions, transferred at least \$8,000 to his joint personal bank account, and wrote a \$20,000 check from his personal bank account to his member firm's clearing firm to pay for transactions effected in his joint trading account that was returned for insufficient funds, causing his firm to be left with a \$21,874.30 debit balance. Furthermore, NASD found that Papeo failed to respond truthfully during an NASD on-the-record interview, failed to respond to NASD requests for documents, and failed to respond to NASD requests to appear for a follow-up on-the-record interview. (NASD Case #C10020094)

**Joseph Eugene Rahm (CRD #3212003, Registered Representative, Overland Park, Kansas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Rahm consented to the described sanction and to the entry of findings that, while employed with a member firm, he converted \$490 to his own use and benefit from a Christmas tree lot at which he was volunteering. (NASD Case #C04020035)

**James Anthony Ross (CRD #718008, Registered Representative, Pitcairn, Pennsylvania)** submitted an Offer of Settlement in which he was fined \$5,000, suspended from association with any NASD member in any capacity for four months, and required to disgorge \$11,800, plus interest, in partial restitution to public customers. The fine and restitution must be paid before Ross reassociates with any NASD member

following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Ross consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm.

Ross' suspension began October 21, 2002, and will conclude at the close of business February 20, 2003. (NASD Case #C9A020032)

**James F. Salata (CRD #1520552, Registered Representative, Amity, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Salata consented to the described sanction and to the entry of findings that he recommended and sold callable Certificates of Deposit (CDs) to public customers and made material misrepresentations during his sales presentations. The findings also stated that Salata misrepresented 15- or 20-year callable CDs as one- or two-year CDs; misrepresented that the CDs would be called within a specific period of time; and informed customers that the callable CDs could be redeemed without penalty at any time with no risk to principal when, in fact, the callable CDs had to be sold on the secondary market to obtain a return of principal prior to maturity with a possible significant loss to principal in such a transaction. In addition, the findings stated that Salata informed customers that they could redeem callable CDs at any time with minimal risk to principal and that any loss would be covered by the interest earned. (NASD Case #CAF020033)

**Ruslan M. Sattarov (CRD #3027779, Registered Representative, Seattle, Washington)** submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Sattarov reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Sattarov consented to the described sanctions and to the entry of findings that he caused the execution of transactions in his mother's securities account at his member firm on an "as of" basis. NASD found that such transactions were entered into the firm's electronic order entry system on a date after the "as of" trade date entered by Sattarov when they should have been entered at the price available on the entry date, not at the more favorable price obtained by entering and executing them on an "as of" basis.

Sattarov's suspension began October 21, 2002, and will conclude at the close of business November 19, 2002. (NASD Case #C3A020026)

**Dennis Patrick Sweenor (CRD #2621311, Registered Representative, Queensbury, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member

in any capacity for six months, and ordered to pay \$2,822.77, plus interest, in restitution to public customers. The fine and restitution must be paid before Sweenor reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Sweenor consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transactions in the accounts of public customers without their prior authorization. The findings also stated that Sweenor negligently misrepresented to public customers that they would be charged commissions on profitable trades only or that the commissions would be three percent of the profits from the customers' accounts.

Sweenor's suspension began October 21, 2002, and will conclude April 20, 2003. (NASD Case #C07020075)

**Stephen Michael Telesca (CRD #1021136, Registered Representative, Fairport, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$14,490 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Telesca consented to the described sanctions and to the entry of findings that he engaged in private securities transactions, for compensation, away from his member firm and failed to provide his firm with detailed written notice of the transactions, his role therein, and to receive permission from the firm to engage in the transactions. The findings also stated that Telesca engaged in outside business activities for compensation, and failed to provide his member firm with prompt written notice of these activities.

Telesca's suspension began November 4, 2002, and will conclude at the close of business December 3, 2002. (NASD Case #C8B020018)

**James Theodore Wade (CRD #1070305, Registered Representative, Fairlawn, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$25,000, suspended from association with any NASD member in any capacity for two years, and ordered to requalify by exam following the suspension before acting in the securities industry in any capacity. The fine must be paid before Wade reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Wade consented to the described sanctions and to the entry of findings that he made material misrepresentations to public customers during the sale of callable CDs. The findings stated that Wade materially misrepresented that the callable CDs were one-year CDs when, in fact, they had 15- or 20-year maturity dates. Wade also misrepresented that the callable CDs could be redeemed without penalty at any time with no risk to principal when, in actuality, the callable CDs must be sold on the secondary market to obtain a return of principal prior to maturity.

Wade's suspension began October 21, 2002, and will conclude at the close of business October 20, 2004. (NASD Case #CAF020044)

**Stanley Walker (CRD #2601447, Registered Representative, Crestwood, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Walker transferred approximately \$35,500 from a public customer's checking account to his own checking account without the customer's knowledge or permission and used the funds for his own benefit. The findings also stated that Walker failed to respond to NASD requests for information. (NASD Case #C10020050)

**James Richard Wamsley (CRD #1149112, Registered Representative, Petaluma, California)** was fined \$5,000 and suspended from association with any NASD member in any capacity for two years. The sanctions were based on findings that Wamsley prepared a letter to a former customer concerning a tax deferred annuity and signed his manager's name to the letter and sent it to the customer without his manager's knowledge and without approval of anyone at his member firm.

Wamsley's suspension began October 7, 2002, and will conclude at the close of business October 6, 2004. (NASD Case #C01010017)

**James Arthur Will (CRD #2701284, Registered Representative, Indianapolis, Indiana)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Will failed to respond to NASD requests for information. The findings also stated that Will engaged in unauthorized transactions. (NASD Case #C8A020026)

**Reinaldo Williams, Jr. (CRD #2419320, Registered Representative, Clifton, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Williams consented to the described sanction and to the entry of findings that, without authorization, he effected numerous transactions in his member firm's error account and then transferred some of the transactions into his personal account. (NASD Case #C9B020069)

**Jeri Lynn Winberg (CRD #3177708, Registered Representative, Poway, California)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Winberg reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Winberg consented to the described sanctions and to the entry of findings that, in an attempt to expedite the opening of a public customer's account, she affixed the customer's name on

an account application and signature card without the customer's knowledge or consent.

Winberg's suspension began November 4, 2002, and will conclude at the close of business December 3, 2002. (NASD Case #C02020049)

**Steven Boyle Yamashiro (CRD #1953754, Registered Principal, Pasadena, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 20 days. Without admitting or denying the allegations, Yamashiro consented to the described sanctions and to the entry of findings that he entered into a written agreement with a public customer in which he guaranteed that he personally would purchase from the customer identified equities in the customer's portfolio, at a pre-determined price, if the price available in the public market did not exceed the customer's acquisition price or a percentage thereof.

Yamashiro's suspension began November 4, 2002, and will conclude November 23, 2002. (NASD Case #C02020048)

## Decisions Issued

The following decisions have been issued by the DBCC or the Office of Hearing Officers and have been appealed to or called for review by the National Adjudicatory Council (NAC) as of October 4, 2002. The findings and sanctions imposed in the decisions may be increased, decreased, modified, or reversed by the NAC. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notices to Members*.

**Anthony Harold Barkate (CRD #1255255, Registered Principal, Bakersfield, California)** was fined \$400,144, to be reduced by any amounts that had been paid in disgorgement of commissions to public customers, and barred from association with any NASD member in any capacity. The sanctions were based on findings that Barkate engaged in private securities transactions without providing prompt written notice to, or receiving approval from, his member firm regarding his activities.

Barkate has appealed this decision to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C02010041)

**Investment Management Corp. (CRD #37196, Salt Lake City, Utah) and Kevin Dee Kunz (CRD #1274540, Registered Representative, Fruit Heights, Utah)** were fined \$28,757, jointly and severally, and Kunz was barred from association with any NASD member as a financial and operations principal, suspended from association with any NASD member in any other principal capacity for six months, and required to re-qualify as a principal. The sanctions were based on findings that the firm, acting through Kunz, conducted a securities business while failing to maintain its minimum net capital requirement and had

inaccurate books and records. The findings also stated that the firm, acting through Kunz, filed inaccurate FOCUS reports; submitted an incomplete and materially inaccurate notice of a possible net capital deficiency; failed to file required information concerning an NASD arbitration award and a settlement; and allowed an inactive person to function in a capacity that required him to be actively registered. In addition, NASD determined that the firm, acting through Kunz, failed to have adequate written supervisory procedures with respect to the reporting of arbitration awards.

This action has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C3A010045)

## Complaints Filed

The following complaints were issued by NASD. Issuance of a disciplinary complaint represents the initiation of a formal proceeding by NASD in which findings as to the allegations in the complaint have not been made, and does not represent a decision as to any of the allegations contained in the complaint. Because these complaints are unadjudicated, you may wish to contact the respondents before drawing any conclusions regarding the allegations in the complaint.

**Joseph Abbondante (CRD #1879052, Registered Representative, Freehold, New Jersey) and Daniel Timothy Pszanka (CRD #2499042, Registered Representative, Denver, Colorado)** were named as respondents in an NASD complaint alleging that they engaged in private securities transactions without prior written notice to, or approval from, their member firm. The complaint also alleges that, in connection with customers' investments in a limited partnership, Abbondante and Pszanka, directly or indirectly, by the use of the means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, employed artifices, devices, or schemes to defraud; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; engaged in acts, practices, or courses of business which operated, or would operate, as a fraud or deceit; and/or effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive, or other fraudulent devices or contrivances. The complaint further alleges that Abbondante and Pszanka engaged in an outside business activity without providing written notice to their member firm. Furthermore, the complaint alleges that Abbondante and Pszanka created and provided investment account statements to public customers that contained purported information with respect to each customer's investment in a limited partnership including the amount and location of their principal investments,

the performance of their investments, and their returns on investments that were false, misleading, deceptive, and without a factual basis. (NASD Case #C10020090)

**Vincent Roger Bickler (CRD #2042291, Registered Representative, Toms River, New Jersey)** was named as a respondent in an NASD complaint alleging that he forged the names of public customers on checks totaling \$1,359 issued to the customers by Bickler's member firm, and deposited the checks into his own personal bank account without the customers' knowledge, authorization, or consent, thereby converting the funds for his own use and benefit. The complaint also alleges that Bickler failed to respond to NASD requests for information and documents. (NASD Case #C10020095)

**William Pang Chien (CRD #2251029, Registered Principal, Plantation, Florida)** was named as a respondent in an NASD complaint alleging that he caused \$350,500.87 to be wire transferred from the accounts of public customers at his member firm to various bank accounts, including accounts under his control, without authorization from the customers, thereby converting the funds. The complaint also alleges that Chien caused \$209,900 to be wire transferred from accounts of public customers at his member firm to various bank accounts, including accounts under his control, without authorization from the customers, and ultimately returned the funds to the customers, thereby misusing customer funds. In addition, the complaint alleges that Chien failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C07020077)

**Laura Leigh Cockrell (CRD #2738492, Registered Representative, Spring Hill, Tennessee)** was named as a respondent in an NASD complaint alleging that she generated checks totaling \$77,100 drawn on her member firm's postage account, public customer accounts, and a firm employee account without their knowledge or consent. The complaint alleges that Cockrell made the checks payable to "W. Cockrell" or "Wesley Cockrell," signed the checks, obtained the required counter signatures, and then endorsed them "For Deposit Only" to an account under her control. The complaint also alleges that Cockrell failed to respond to NASD requests for information. (NASD Case #C05020046)

**John Christian Ferraro (CRD #2756017, Registered Representative, Islip, New York)** was named as a respondent in an NASD complaint alleging that he executed transactions in the account of a public customer without the customer's prior knowledge, authorization, or consent. The complaint also alleges that Ferraro exercised discretion in the accounts of public customers without obtaining their prior authorization or obtaining his member firm's prior written acceptance of the accounts as discretionary. In addition, the complaint alleges that Ferraro executed transactions in the account of a public customer without reasonable grounds for believing that the level

of activity represented by the transactions was suitable for the customer based on his financial situation, investment objectives, and needs. (NASD Case #C10020088)

**Howard Scott Ismark (CRD #2928579, Registered Representative, North Miami Beach, Florida)** was named as a respondent in an NASD complaint alleging that he effected, or caused to be effected, transactions in the accounts of public customers without their prior authorization. The complaint also alleges that Ismark participated in a private securities transaction without providing prior written notice to his member firm. In addition, the complaint alleges that Ismark failed to respond to NASD requests for information and documents. (NASD Case # C07020070)

**Barry Alan Kaufman (CRD #2774898, Registered Representative, Boca Raton, Georgia)** was named as a respondent in an NASD complaint alleging that he effected unauthorized trades in the account of a public customer. The complaint also alleges that Kaufman failed to respond to NASD requests for documents and to provide a written statement. (NASD Case #C07020078)

**Richard Anthony Takacs (CRD #2479382, Registered Principal, Holbrook, New York)** was named as a respondent in an NASD complaint alleging that he effected transactions in the accounts of public customers without their prior knowledge, authorization, or consent. The complaint also alleges that Takacs failed to respond truthfully and non-deceptively during an NASD on-the-record interview. In addition, the complaint alleges that Takacs prepared and mailed a letter to public customers and failed to obtain approval of the letter from a designated principal at his member firm prior to mailing the letter. (NASD Case #C10020096)

**Emerson Victor Yang (CRD #2949183, Registered Representative, West New York, New Jersey)** was named as a respondent in an NASD complaint alleging that he engaged in a fraudulent scheme to profit at his customer's expense by secretly placing matched buy and sell orders in the after-hours market between the customer's account at his member firm and a personal account that he maintained secretly at another broker/dealer. The complaint also alleges that Yang, by placing buy and sell orders in a customer account for his personal benefit rather than for the benefit of the customer, made improper use of customer securities and funds. The complaint further alleges that Yang failed to notify his member firm of his outside brokerage account, and failed to notify the broker/dealer holding the account that he was associated with another member firm. In addition, the complaint alleges that Yang failed to respond to NASD requests for information and to appear for testimony. (NASD Case #CMS020159)

## **Firms Expelled for Failing to Pay Fines and/or Costs in Accordance with NASD Rule 8320**

**Cybervest Securities, Inc.**  
Brooklyn, New York  
(October 9, 2002)

**William & Co. Capital Markets**  
New York, New York  
(October 9, 2002)

## **Firms Suspended for Failure to Supply Financial Information**

The following firms were suspended from membership in NASD for failure to comply with formal written requests to submit financial information to NASD. The action was based on the provisions of NASD Rule 8210 and Article VII, Section 2 of the NASD By-Laws. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

**International Securities Corporation**  
New York, New York  
(October 8, 2002 - October 11, 2002)

**Kersey, Scillia, Forster and Brooks, Inc.**  
Ft. Lauderdale, Florida  
(October 8, 2002)

**Platinum Investment Corporation**  
Rochester, New York  
(October 7, 2002)

**Webel-Roth Securities, Inc.**  
Boca Raton, Florida  
(October 14, 2002)

## **Suspension Lifted**

NASD has lifted the suspension from membership on the date shown for the following firm because it has complied with formal written requests to submit financial information.

**Electronic Specialist, LLC**  
New York, New York  
(September 17, 2002)

**Firm Suspended Pursuant to NASD Rule Series 9510 for Failure to Comply With an Arbitration Award, a Settlement Agreement, or Arbitration Fees**

The date the registration was suspended is included after the entry. Since the firm has complied, the listing also includes the date the suspension was lifted.

**Beckwith & Co., Incorporated**  
Bonita Springs, Florida  
(October 3, 2002 – October 11, 2002)

**Individuals Barred Pursuant to NASD Rule 9544 for Failure to Provide Information Requested Under NASD Rule 8210.**

(The date the bar became effective is listed after the entry.)

**Albers, Joseph R.**  
Gig Harbor, Washington  
(September 30, 2002)

**Anonuevo, Noel Mendoza**  
Hercules, California  
(September 30, 2002)

**Fishbein, Michael B.**  
Bronx, New York  
(September 23, 2002)

**Hsu, John S.**  
Alhambra, California  
(September 12, 2002)

**Paulsen, Curtis C.**  
Ballwin, Missouri  
(September 23, 2002)

**Sweidan, Kamil H.**  
Naples, Florida  
(September 30, 2002)

**Weinstock, Jason H.**  
Van Nuys, California  
(September 12, 2002)

**Individuals Suspended Pursuant to NASD Rule 9541(b) for Failure to Provide Information Requested Under NASD Rule 8210.**

(The date the suspension began is listed after the entry. If the suspension has been lifted, the date follows the suspension date.)

**Coleman, Joseph C.**  
Coraopolis, Pennsylvania  
(October 4, 2002)

**Fried, Lanny T.**  
New York, New York  
(September 17, 2002)

**Gates, Frank Jay**  
Roseville, California  
(September 20, 2002)

**George, Audrey Sue**  
Littleton, Colorado  
(September 17, 2002)

**Ko, Benny**  
Walnut, California  
(September 12, 2002)

**Koupas, Harry**  
Dallas, Texas  
(October 4, 2002)

**Lisnoff, Jr., Robert W.**  
Medford, New York  
(September 30, 2002)

**O'Connor, Theresa A.**  
San Francisco, California  
(September 20, 2002)

**Rojas, Ramiro**  
Elk Grove, California  
(September 18, 2002 – September 19, 2002)

**Toyin-Oke, Tajudeen T.**  
Randallstown, Maryland  
(October 4, 2002)

**Individuals Suspended Pursuant to NASD Rule Series 9510 for Failure to Comply With an Arbitration Award or a Settlement Agreement**

The date the registration was suspended is included after the entry. If the individual has complied, the listing also includes the date the suspension was lifted.

**Betta, Jr., William**  
Boca Raton, Florida  
(September 10, 2002)

**Brown, James R.**  
Medford, New York  
(September 30, 2002)

**St. John, Kert L.**  
San Diego, California  
(October 3, 2002)

## **Individuals Revoked for Failing to Pay Fines and/or Costs in Accordance with NASD Rule 8320**

**Angrisani, Edward D.**  
Skillman, New Jersey  
(October 9, 2002)

**Chien, William P.**  
Plantation, Florida  
(October 9, 2002)

**Goritz, George M.**  
New York, New York  
(October 9, 2002)

**Hanson, Luther A.**  
Charlestown, West Virginia  
(October 9, 2002)

**Nguyen, Hao**  
Houston, Texas  
(October 9, 2002)

**Palermo, John M.**  
Holbrook, New York  
(October 9, 2002)

**Perles, Howard R.**  
Staten Island, New York  
(October 9, 2002)

## **NASD Charges New York Broker Todd M. Eberhard with Numerous Sales and Reporting Violations**

NASD charged Todd M. Eberhard, the majority owner of Park South Securities, LLC, with multiple violations of securities laws and NASD rules. The charges include securities fraud, issuing false account statements, settling customer complaints at three firms where he previously worked without the prior approval of the firms, and numerous Central Registration Depository (CRD) reporting violations.

The complaint alleges that during the last several years, Eberhard committed securities fraud in connection with scores of mutual fund transactions. Among other abuses, Eberhard engaged in a pattern of short-term trading of mutual funds and purchasing large volumes of class B mutual fund shares. NASD's review of the accounts revealed patterns of improper short-term trading of mutual funds in order to maximize commissions.

Through large purchases of class B shares, Eberhard kept his customers from taking advantage of the lower sales charges available through different classes of funds. In one customer's account, a mutual fund position was held for just 10 days. In another customer's accounts, despite a \$250,000 purchase limit on class B shares imposed by the mutual fund distributor, Eberhard effected total purchases of more than \$700,000 of class B shares of the fund.

Many customers eventually complained to Eberhard about the activity in their accounts. Eberhard agreed to settle many of these complaints; however, in 14 instances he did so improperly, without the prior knowledge and consent of his employer brokerage firms. The settlements were often large, with Eberhard agreeing to pay some customers hundreds of thousands of dollars, and in one case, \$2 million.

In at least one instance, Eberhard issued statements that included false valuations intended to induce the customer to keep his accounts with Eberhard.

In many instances, Eberhard failed to report the customer complaints and settlements to NASD on his Form U-4, thus failing to update the CRD system. In some cases, even when Eberhard filed amendments to his Form U-4, he misrepresented the underlying facts of the customer's complaint and settlement.

Eberhard also entered into a number of written settlement agreements with customers that included improper confidentiality clauses. These provisions effectively prohibited the customers from disclosing the facts of their complaints and the settlement terms to NASD.

Under NASD rules, an individual named in a complaint can file a response and request a hearing before an NASD disciplinary panel. Possible sanctions include a fine, censure, suspension, or bar from the securities industry, in addition to the request made by NASD in the complaint that the respondent give up any ill-gotten gains and pay restitution.

## **NASD Settles Charges Against Swift Trade Securities for Deceptive Trading and Non-Bona Fide "Wash" Transactions in QQQ**

NASD reached a settlement with Swift Trade Securities USA, Inc. and its President, Peter Beck, for engaging in a deceptive trading scheme involving fictitious "wash" transactions in the NASDAQ-100 Index Tracking Stock (QQQ) in an effort to obtain market data revenue generated from such transactions.

Swift USA and Beck were censured and fined, jointly, \$75,000 and were required to give up \$26,000, the profits from the fictitious wash sales. NASD suspended Beck for 30 business days in all capacities, and censured and fined Joseph Ianni, Vice President of Compliance and Swift USA, jointly, \$25,000 for inadequate supervision.

From April 2002 through May 2002, Swift USA, an NASD-registered brokerage firm based in Toronto, Canada, operated a computer software program that simultaneously routed offsetting limit orders for QQQ to The Island ECN, Inc. The orders were solely for the account of Swift USA's only customer and Canadian-registered counterpart, Swift Trade Securities, Inc. Because Swift USA executed these orders for a single customer at the same price and quantity on both sides of the market,

there was no change in Swift Canada's ownership of QQQ shares. Fictitious and non-bona fide transactions that do not result in a change of ownership are illegal.

NASD found that Swift USA, through Beck, violated NASD rules by executing these "wash" transactions through Island to profit from the market data revenue sharing provided by Island to its subscribers, while not subjecting Swift Canada to the risk of profit or loss from the underlying trading. As a result of this trading strategy, Swift USA received approximately \$26,000 in illegal data revenue.

NASD also found that Swift USA and Joseph Ianni inadequately supervised the trading in Swift USA's proprietary account. In settling this matter, all Respondents neither admitted nor denied NASD's findings.

### **NASD Charges Two Minneapolis Brokers with Insider Trading; Settles with Three Others**

NASD issued a complaint charging two Minneapolis, MN, brokers with insider trading. Thomas D. Krosschell and Joseph A. Geraci II have been charged with buying the common stock of Minnesota American, Inc. (OTCBB: MNAC) while in possession of inside information about a potential reverse merger between MNAC and Berthel Fisher & Co. Financial Services, Inc., an Iowa-based brokerage firm. At the time, Krosschell and Geraci were working at now defunct Maven Securities, which had been retained by MNAC as the company's investment bankers.

In a related action, NASD announced that it has settled insider trading charges with three other former employees of Maven Securities: Daniel J. Shrader, the president of the firm; Troy W. Johnson, a broker; and Michael E. Cain, a sales assistant, for purchasing MNAC stock while in possession of material inside information about the company.

In the complaint, NASD alleges that Krosschell and Shrader presented the idea of a reverse merger to MNAC and Berthel Fisher. As they were negotiating details of the potential merger, Krosschell and Shrader purchased more than 100,000 shares of MNAC stock. The complaint further alleges that they tipped approximately 20 others to purchase the stock including all of the firm's brokers. Shortly after news of the planned merger was announced, Krosschell and Shrader began to sell the stock, generating realized profits of approximately \$90,000. The proposed merger fell through, and MNAC later merged with CorVu Corporation (OTCBB: CRVU).

According to the complaint, Krosschell and Geraci violated federal securities laws and NASD rules by purchasing MNAC stock while in possession of inside information about the company's potential reverse merger with Berthel Fisher. In settling the matter, Shrader and Johnson each consented to a permanent bar from association with any NASD member, while Cain consented to a one-year suspension.

Under NASD rules, the individuals named in the complaint may file a response and request a hearing before a disciplinary panel. Possible sanctions include a fine, disgorgement, suspension or bar from NASD.

### **NASD Hearing Panel Bars Broker for Evading Federal Currency Reporting Requirements**

An NASD Hearing Panel barred Christian W. Baker, a Livonia, MI, registered representative, from the securities industry for structuring currency transactions in an effort to evade currency-reporting requirements and failing to file required Currency Transaction Reports (CTR).

On July 10, 2001, NASD filed a complaint against Baker alleging, among other things, that she violated NASD Rules by structuring currency transactions to evade federal reporting requirements and causing an NASD member firm to fail to file a CTR.

"It is imperative in today's world that the front lines of our industry adhere to procedures that may help identify transactions that may have dubious origins," said Mary L. Schapiro, NASD President of Regulatory Policy and Oversight. "As this action illustrates, we will identify and sanction those in our industry who try to circumvent these procedures."

Financial institutions, including broker/dealers, are required to report cash transactions of more than \$10,000 to the federal government by filing a CTR. Federal law prohibits any person from structuring transactions or assisting in the structuring of transactions to evade reporting requirements. Federal law also prohibits any person from causing or attempting to cause a financial institution to fail to file CTRs.

The Hearing Panel, in its decision, found that Baker accepted \$50,000 in cash from a customer who insisted that the transaction not be reported. After learning from a bank teller that reports were not required for cashier's checks issued in amounts of less than \$3,000, Baker began to periodically exchange the customer's cash for cashier's checks in amounts of less than \$3,000. The Panel found that over a four-month period, Baker purchased 24 separate cashier's checks in amounts of less than \$3,000, eventually depositing the entire \$50,000 that was being held in her desk drawer into the customer's account.

The Hearing Panel also found that Baker did not record the receipt of the \$50,000 in cash, did not notify her employer or the U.S. Department of the Treasury that she had indeed received the cash, and failed to file the required CTR. Baker's failure to inform her employer of the transaction caused the firm, in turn, fail to file the required CTR. The Panel also found that Baker structured the 24 purchases of cashier's checks for the express purpose of preventing her employer from complying with the reporting requirements.

The Panel noted in its decision that the currency reporting statute protects the taxing power of the U.S. Government, as well as inhibits the flow of cash to terrorist organizations. The Panel found that Baker's conduct undermined those purposes and those of the federal securities laws. In imposing the bar from associating with any NASD member, the Panel found that Baker's conduct was intentional and specifically designed to evade the reporting requirements mandated by federal law.

### **Salomon Smith Barney Fined \$5 Million for Issuing Misleading Research Reports on Winstar; Charges Filed Against Jack Grubman and Christine Gochuico**

NASD fined Salomon Smith Barney \$5 million for issuing materially misleading research reports in 2001 on Winstar Communications, Inc. Separately, NASD announced that it filed a complaint against Jack Grubman, formerly the Managing Director of the firm's Equity Research Department, and Christine Gochuico, a Salomon Vice President and an assistant to Grubman, concerning the same conduct. Grubman and Gochuico authored the reports that were the focus of the inquiry.

The settlement between NASD and Salomon resolves a singular NASD investigation into Salomon's Winstar reports and does not address other, larger Salomon-related research analyst investigations currently underway by NASD and other regulators.

"What occurred in this case was a serious breach of trust between Salomon and its investors," said Mary L. Schapiro, NASD's President of Regulatory Policy and Oversight. "It should go without saying that reports issued for investors' use must be truthful. This case, along with others already filed and those under active investigation, make it clear that strong enforcement action will be taken against brokerage firms and their analysts who issue misleading research."

The settlement against Salomon Smith Barney is NASD's third largest in history.

Winstar was a broadband telecommunications service provider that filed for bankruptcy last year. Salomon's research reports strongly recommended Winstar as a "Buy"—Salomon's top rating—with a 12- to 18-month target price of \$50 even as the stock plummeted from approximately \$20 on January 25, 2001, to 14 cents on April 17 of that year. In the settlement today, Salomon agreed to findings that it did not have a reasonable basis for that target price.

Salomon had a significant investment banking relationship with Winstar. Beginning in February 1999 through July 2001, Salomon helped Winstar raise more than \$5.6 billion, receiving fees of approximately \$24 million for those services. Even as Winstar's prospects were falling and its stock price collapsing, Salomon worked with Winstar to address its funding needs, a relationship that continued even after the company filed for bankruptcy.

Grubman and his assistant worked closely with Winstar's management. They consulted Winstar's management prior to issuing research reports and financial models that purportedly reflected their independent judgment and analysis. For example, they sent Winstar officials the financial model they had created to analyze Winstar, and that yielded the target price, for approval before making it publicly available.

NASD found that Salomon's reports failed adequately to disclose the risks of investing in Winstar, including important risks relating to funding and bankruptcy. The reports contained repeated strong praise for Winstar, while belittling other analysts who were critical of the company. Some of the rebuttals were false and misleading.

The complaint against Grubman and Gochuico charges that e-mails and other internal Salomon documents demonstrate that, while they were publicly recommending Winstar to investors, they expressed contrary views in private. In various private communications, both Grubman and Gochuico highlighted risks of investing in Winstar and expressed doubts about Winstar's ability to obtain funds. Those risks and doubts were never disclosed to the investing public.

Some of the private communications included:

- ◆ Salomon's target price of "\$50 per share is shall we say—extremely aggressive";
- ◆ An unwillingness to change the firm's target price because of "optics"; and
- ◆ Privately telling others to sell at prices far below the \$50 target price.

During this same period, Winstar, which traded on NASDAQ, had suffered significant losses, needed large amounts of capital to operate, and was heavily dependent on external sources for financing. In 2000, it had a net loss of almost \$900 million. In April 2001, it filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code.

Grubman and Gochuico initiated research coverage of Winstar with a Buy rating in January 1998. At that time, Winstar's market capitalization was almost \$1 billion. They maintained a target price of \$50 per share from October 2000, when Winstar's market capitalization was approximately \$2.8 billion, until April 2001. By April 18, Winstar's market capitalization had fallen by more than 99 percent to approximately \$13 million. Grubman acknowledged in an internal e-mail in May 2001, "If anything the record shows we support our banking clients too well and too long."

In settling this matter, Salomon neither admitted nor denied NASD's findings.

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## For Your Information

### Reminder to NASD Members – Transactions with NASD and American Stock Exchange Employees

NASD members who carry brokerage accounts for NASD, NASDAQ, or American Stock Exchange employees are reminded of the need to promptly implement employees' instructions calling for duplicate statements to be provided to NASD. This requirement is set forth in NASD Rule 3090(a), which provides that "[w]hen a member has actual notice that an Association or American Stock Exchange employee has a financial interest in, or controls trading in, an account, the member shall promptly obtain and implement an instruction from the employee directing that duplicate account statements be provided by the member to the Association."<sup>1</sup>

Rule 3090(a), which became effective on November 17, 2000, plays a vital role in helping NASD monitor whether employees are abiding by trading restrictions imposed by the NASD Code of Conduct. Among other things, employees may not own stock of broker/dealers or companies that derive more than 25 percent of their gross revenues from broker/dealer activities, or stock purchased as part of an initial public offering. NASD reviews duplicate statements for employees' brokerage accounts to ensure that employees have abided by these restrictions.

With respect to new accounts, the information necessary to give members actual notice of an employee's interest in an account is already included on the new account forms used by most broker/dealers, and on a standardized duplicate instruction form that NASD and Amex employees can provide to their broker/dealers. It is not necessary for an NASD official to issue a letter authorizing the opening of each employee account.

With respect to existing accounts, Rule 3090(a) contemplates that NASD and Amex employees will use the above-referenced duplicate instruction form to give NASD members actual notice of their interest in an account. A member receiving such a form must promptly implement the duplicate statement instruction.

Rule 3090(a) applies to accounts opened after the rule became effective on November 17, 2000, and to those pre-existing accounts as to which an NASD member has actual notice that an NASD or Amex employee has financial interest or controls trading. NASD members are not required to review accounts that existed before

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## For Your Information

the rule became effective to identify those in which NASD or Amex employees may have an interest or control trading.

NASD members with questions concerning Rule 3090(a) may contact Luley Chow, NASD Code of Conduct Administrator, NASD Office of General Counsel, at [luley.chow@nasd.com](mailto:luley.chow@nasd.com) or (202) 728-8315

<sup>1</sup> NASD Rule 0120(b) defines "Association" as meaning, collectively, NASD, NASD Regulation, NASDAQ, and NASD Dispute Resolution.

### Filing of Annual Attestation Required by Rule 2711 - Research Analysts and Research Reports

On May 10, 2002, the SEC approved new NASD Rule 2711, Research Analysts and Research Reports, which is intended to address conflicts of interest that can arise when securities analysts issue recommendations in research reports and public appearances and provide investors with more objective, reliable, and useful information. Most of the Rule is already in effect; the remaining provisions become effective on November 6, 2002.

Rule 2711(i) requires each member subject to the rule to adopt and implement written supervisory procedures that are reasonably designed to achieve compliance with the rule's provisions. The rule further requires that a senior officer of the member attest annually to NASD that it has adopted and implemented such procedures.

This notice is to advise members that the annual attestation must be received by NASD no later than the last business day of each calendar year. The attestation should be sent to the following address:

Department of Member Regulation  
NASD Division of Regulatory Policy and Oversight  
Attn: Rule 2711 Attestation  
1735 K Street, NW  
Washington, DC 20006

Questions concerning this information should be directed to the Department of Member Regulation, Regulatory Policy and Oversight, at (202) 728-8221.