

DECEMBER 2003

# Notices to Members

## Notices

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## For Your Information

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## Disciplinary and Other NASD Actions

Reported for November

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# Notice to Members

DECEMBER 2003

REQUEST FOR COMMENT

ACTION REQUESTED BY JANUARY 9, 2004

## SUGGESTED ROUTING

Executive Representatives  
Registered Representatives  
Legal & Compliance  
Senior Management

## NASD Seeks Comment on Enhanced Access to NASD BrokerCheck (Formerly Known as NASD's Public Disclosure Program)

Access to Information Available Under Interpretive Material 8310-2; **Comment Period Expires January 9, 2004**

## KEY TOPICS

Central Registration Depository  
NASD BrokerCheck/Public Disclosure Program  
IM-8310-2

### Executive Summary

Interpretive Material 8310-2 (IM-8310-2) governs the release of disciplinary and other information to the public through NASD BrokerCheck. In July 2002, NASD initiated a comprehensive review of the information that it makes public, including the information released under IM-8310-2. In November 2002, NASD requested comment on its public information review initiative in *Notice to Members 02-74*. Based on NASD's review and member, investor, and other comments, the NASD Board of Governors (NASD Board), at its July 31, 2003 meeting, authorized proposed changes to IM-8310-2 that would broaden the scope of administrative and disclosure information NASD releases to the public. These proposed changes adopt a principled and consistent approach to disclosure and reflect NASD's commitment to strike a fair balance between investor protection and the legitimate privacy interests of brokers. NASD has submitted a rule filing with the Securities and Exchange Commission (SEC) seeking approval of the proposed changes.

In connection with the proposed changes to IM-8310-2, and the overall objectives of the public information review that led to these changes, NASD is seeking comment on proposed enhancements to the existing approach for the electronic delivery of written reports (e-mail) used by the NASD BrokerCheck Program. These enhancements, which include a link to a secure written report, are intended to address investor needs and enhance the security and integrity of the program.

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## Action Requested

NASD encourages all interested parties to comment on the proposal. Comments must be received by January 9, 2004. Members and interested persons can submit their comments using the following methods:

- ▶ mailing in written comments
- ▶ e-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com)
- ▶ submitting comments online at the NASD 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 Notes:** The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web Site. Generally, comments will be posted on the NASD Web Site one week after the end of the comment period. See *Notice to Members 03-73*.

Before becoming effective, any rule change developed as a result of comments received must be adopted by the Regulatory Services and Operations Committee of the NASD Board, may be reviewed by the NASD Board, and must be approved by the SEC following public comment.

## Questions/Further Information

Questions concerning this *Notice* may be directed to Ann E. Bushey, Director, Registration and Disclosure, at (240) 386-4724; Richard E. Pullano, Associate Vice President/Chief Counsel, Registration and Disclosure, at (240) 386-4821; or Patricia M. Albrecht, Assistant General Counsel, at (202) 728-8026.

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## Background

IM-8310-2 governs the release of disciplinary and other information to the public through, among other means, NASD BrokerCheck. The BrokerCheck program processes over two million inquiries a year and provides investors with an unparalleled ability to obtain information essential to making an informed choice on whether to do business with a securities firm or an individual broker. Investors may request information either by accessing a toll-free telephone number (800-289-9999) or by visiting NASD's Web Site ([www.nasd.com](http://www.nasd.com)). As the program has grown, investors and other users have shown a marked preference for requesting and receiving information from the program electronically. Notwithstanding the toll-free number, NASD receives over 98 percent of program inquiries online, and the vast majority of investors and other requesters prefer to receive written NASD BrokerCheck reports electronically. In addition to this preference for electronic access and report distribution, investors want to receive more complete information from the program. They have consistently expressed a need for material that explains what the information they receive means and its importance to their decision whether to do business with a securities firm or an individual broker.

In July 2002, NASD initiated a comprehensive review of, among other things, the information that it makes public through IM-8310-2(a). In November 2002, NASD requested comment on the public information review initiative in *Notice to Members 02-74*. Based on NASD's review and member, investor, and other comments, the NASD Board, at its July 31, 2003 meeting, authorized proposed changes to IM-8310-2 that would change the scope of administrative and disclosure information NASD releases through its public disclosure program. These proposed changes adopt a principled and consistent approach to disclosure and reflect NASD's commitment to strike a fair balance between investor protection and the legitimate privacy interests of brokers. NASD has submitted a rule filing with the SEC seeking approval of the proposed changes.<sup>1</sup>

In connection with the proposed changes to IM-8310-2, and the overall objectives of the public information review that led to these changes, NASD is seeking comment from members and other interested parties regarding proposed enhancements to the existing approach for the electronic delivery of written reports (e-mail) generated by NASD BrokerCheck.

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## Comment Requested on Enhanced Electronic Distribution of Written Reports

In addition to expanding the scope of the information that may be disclosed through NASD BrokerCheck, NASD is considering enhancing the way in which investors or other requesters may obtain this information and is seeking comment on these proposed enhancements. Currently, NASD makes written reports available by U.S. Mail in printed (hard copy) form and by e-mail in an electronic format upon receipt of a request via e-mail or the established toll-free number.<sup>2</sup> These written reports provide administrative and disclosure information on NASD-registered firms and persons (as well as firms and persons whose NASD registrations were terminated within the last two years) and are principally intended to assist investors who may be interested in doing business with a firm or broker.

NASD is proposing to enhance e-mail delivery of written reports by replacing the report attachment currently sent by e-mail with a unique access code and a link to a secure written report server, which NASD would send by e-mail. Individuals could access this server only with the requisite access code, and such access would be limited to the specific written report requested. Under the proposed approach, a person requesting a written report on a firm or broker in electronic format would provide his or her e-mail address. In response, NASD would send an e-mail to the individual providing a unique access code and a link to a secure written report server. The investor or other requester would use the access code and link to access the report on the requested firm or broker. The secure server would be accessible only to individuals who received the link (i.e., the URL address) and access code from NASD. NASD plans to implement security features and access controls to minimize the risk of unauthorized use of the secure written report server and of individual written reports. Once granted access to the requested written report, investors or other requesters would be able to view the written report electronically and print the report at their discretion. Investors also would be able to view investor education materials that would aid them in understanding the written report. NASD would continue to accept requests for reports via the toll-free number and provide hard-copy reports to those requesters.

NASD believes that this proposed method of distribution is an improvement over the current distribution process. Users of the current program strongly prefer receiving written reports in an electronic format.<sup>3</sup> However, a number of practical issues have arisen regarding e-mail delivery. For example, many Internet service providers limit the size of attachments that can be received by an individual via e-mail. Accordingly, NASD sends any written report that exceeds one megabyte (including, for example, reports on the largest NASD-registered broker/dealers) in hard copy via U.S. Mail. This is an inconvenience for investors who are expecting a written report via e-mail, rather than a hard-copy report.

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Also, investors often have requested additional information from NASD to explain the meaning of the information provided through the program. Adding this explanatory material would increase the overall size of the e-mail and would result in an even greater number of reports exceeding the one-megabyte threshold. In addition, e-mail distribution of explanatory material would require inclusion of all relevant explanatory material in every e-mail because there is no practical way to know in advance the specific needs or questions of each investor. The proposed delivery system would give NASD the flexibility to more easily provide contextual and other investor education material as part of the program.

NASD believes that these enhancements will make NASD BrokerCheck easier to use and make the information provided through the program easier to understand by investors and other users by, among other things, providing investors with ready access to investor education materials that will provide context and address specific questions they may have about the information provided to them through the program. These changes also will provide investors and other requesters with electronic format written reports that are more readily accessible and more secure.

### Proposed Action

NASD proposes enhancing the e-mail delivery of written reports by replacing the report attachment currently sent by e-mail with a unique access code and a link to a secure written report server. Only individuals with the requisite access code would be granted access to this server, and access would be limited to the specific written report requested. Once granted access to the requested written report, requesters would be able to view the written report electronically and print the report at their discretion. Requesters also would be able to view investor education materials that would aid them in understanding the written report.

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## Request For Comment

NASD requests comment on the following questions:

- (1) Should NASD implement an enhanced electronic delivery method for NASD BrokerCheck program reports that would replace the current e-mail system?
- (2) What alternative technical solutions, if any, can you suggest for NASD to consider that will achieve the objectives of the program?
- (3) How long should an authorization code remain valid? Should access to the report be unlimited during the time the authorization code is valid (or should access also be limited to a certain number of viewings of the report)?
- (4) What additional protections, if any, can you suggest for NASD to consider that might prevent misuse of the proposed system? For example, should NASD add a message to all outgoing reports requesting recipients to notify NASD if they did not request the report?

## Endnotes

- 1 File No. SR-NASD-2003-168. NASD will alert members when the SEC publishes the rule filing and remind them of their opportunity to comment.
- 2 NASD voluntarily initiated the disclosure program as an investor protection service in 1988. In an endorsement of the program, Congress added Section 15A(i) to the Securities Exchange Act of 1934, which mandated that NASD implement a toll-free telephone number to receive inquiries regarding disciplinary actions involving its members and associated persons and promptly respond to such inquiries in writing.
- 3 For example, in 2002, 93 percent of requesters elected to receive written reports in an electronic format, while only 7 percent elected to receive hard-copy reports via U.S. Mail.

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# Notice to Members

DECEMBER 2003

REQUEST FOR COMMENT

ACTION REQUESTED BY JANUARY 23, 2004

## SUGGESTED ROUTING

Advertising/Investment Companies  
Executive Representatives  
Legal & Compliance  
Mutual Fund  
Senior Management

## KEY TOPICS

Advertising  
Mutual Fund Expenses  
Investment Companies  
NASD Rules 2210 and 2211

## Disclosure of Mutual Fund Expense Ratios in Performance Advertising

NASD Requests Comment on Proposed Amendments to Rules 2210 (Communications With the Public) and 2211 (Institutional Sales Material); **Comment Period Expires January 23, 2004**

### Executive Summary

NASD proposes to amend Rules 2210 and 2211 to require all member communications with the public that contain investment company performance information ("performance advertising") to present specified information about the fund's expenses and performance in a prominent text box. These new requirements would improve investor awareness of the costs of buying and owning a mutual fund, facilitate comparisons among funds, and make presentation of standardized performance more prominent. NASD's proposal would require that:

- ▶ All performance advertising contain a text box that sets forth the fund's (a) standardized performance information; (b) maximum sales charge; and (c) annual expense ratio; and
- ▶ The text box information be presented in type size at least as large as non-standardized performance, if non-standardized performance information is included.

### Questions/Further Information

Questions concerning this *Notice* may be directed to Angela C. Goelzer, Counsel, Investment Company Regulation, Regulatory Policy and Oversight, at (202) 728-8120.

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## Request for Comment

NASD requests comment on the proposed amendments to Rules 2210 and 2211 described in this *Notice*. Members wishing to comment must make a submission that is received by January 23, 2004. Members and interested persons can submit their comments using the following methods:

- ▶ Mailing in written comments;
- ▶ E-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com); or
- ▶ Submitting comments online at the NASD 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, D.C. 20006-1500

**Important Notes:** The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web Site. Generally, comments will be posted on the NASD Web Site one week after the end of the comment period. See *Notice to Members 03-73*.

Before becoming effective, any rule change developed as a result of comments received must be adopted by the NASD Regulation Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the SEC.

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## Background

The content of performance advertising is governed primarily by SEC and NASD rules.<sup>1</sup> NASD Rules 2210 and 2211 set forth NASD standards, and Rule 482 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act of 1940 set forth SEC requirements. These rules help to ensure that these communications are fair, balanced, and not misleading.

### 1. NASD Rules 2210 and 2211

Rule 2210 governs communications with the public, including performance advertising. Rule 2210(d) provides that all member communications with the public must be based on principles of fair dealing and good faith, and should provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry, or service. The rule further provides that “no member may omit any material fact or qualification” if the communication would cause the material to be misleading. In addition, Rule 2210(e) requires that members’ public communications comply with all applicable rules of the SEC.

NASD applies the standards of Rule 2210 and applicable SEC rules through the filing requirements and review procedures of Rule 2210(c). Generally, all advertisements and sales literature concerning registered investment companies must be filed with NASD within ten days of first use or publication.<sup>2</sup> NASD staff reviews each piece to ensure that it is consistent with applicable SEC and NASD rules.

NASD has not interpreted Rule 2210 to require performance advertising to include a fund’s expense ratio. In addition, NASD does not have specific rules about how standardized performance information must be presented in all performance advertising.

Rule 2211 governs institutional sales material and correspondence. Rule 2211 was adopted to create a separate rule for these communications and to present the requirements that apply to these communications in a more easily understandable format.<sup>3</sup> Rule 2211(d)(1) provides that all institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1) and the applicable Interpretive Materials under Rule 2210.

### 2. SEC Rules 482 and 34b-1

Rule 482 and Rule 34b-1 permit an investment company to include performance information in sales material. If performance information is included, the SEC requires disclosure of the fund’s maximum sales charges and its average annual total return for the most recent 1, 5, and 10-year periods, as of the most recent calendar quarter. The total return must be calculated according to standards set forth by the SEC, taking into account sales charges and expenses. These returns are generally referred to as standardized performance. These rules also require that the standardized performance figures be presented at least as prominently as any non-standardized performance information included in the sales material.

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On September 24, 2003, the SEC adopted amendments to Rule 482 and 34b-1 to require mutual fund sales material to convey balanced information to investors, particularly with regard to past performance. The amendments require a fund that advertises performance to make available, by toll-free telephone or Web site, standardized performance returns that are current to the most recent month-end. The amendments also require that performance advertisements include a legend alerting investors that past performance does not guarantee future results, and that current performance may be higher or lower than the performance quoted. These advertisements also must now highlight the availability of information in the prospectus about a fund's objectives, risks, and expenses. The amendments do not specifically address the manner in which standardized performance information must be presented or require the inclusion of a fund's expense ratio in performance advertising.

## The Proposal

Congress, regulators, and investors increasingly have expressed concerns over the need for improved disclosure of fund expenses. These concerns are fueled in part by the increased prominence of mutual funds as an investment vehicle for millions of middle-class American investors. Approximately 95 million shareholders in 54.2 million U.S. households own mutual funds, figures that represent about half of all American households.<sup>4</sup>

The focus on fund fees is important because fees can have a dramatic impact on an investor's return. With these considerations in mind, NASD proposes two improvements to performance advertising regulation. First, NASD proposes to require disclosure of a fund's annual expense ratio in performance advertising. Second, NASD proposes to provide more specific standards to ensure that standardized performance information is presented with sufficient prominence and clarity.

By amending Rule 2210 to require the inclusion of a fund's expense ratio in performance advertising, NASD will help to ensure that each investor whose purchase of mutual fund shares may be influenced by performance advertising will be made aware of the fees charged to purchase and own the fund. By requiring that standardized performance information be presented prominently in a text box along with the fund's maximum sales charge and annual expense ratio, the amendments will ensure that these key items of information are presented in a manner that promotes investor awareness. They also will ensure that standardized performance information is presented at least as prominently as non-standardized performance.

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The proposal would amend Rule 2210 to require that any investment company communications with the public that include performance information permitted by Rule 482 or Rule 34b-1 also disclose:

- ▶ The standardized information required by Rule 482 and Rule 34b-1;
- ▶ The fund's maximum sales load; and
- ▶ The fund's annual operating expenses.

The rules would require that this information be presented in a prominent text box in a type size at least as large as that used to present non-standardized performance information. NASD recognizes that standardized mutual fund performance information already reflects the fund's sales load and expenses. Indeed, the disclosure required by this proposal would state this fact. NASD believes that, just as presentation of the maximum sales load informs customers about one-time charges that they may incur if they purchase the fund, disclosure of the expense ratio would provide investors with critical information about the annual expenses that they would incur. Consequently, the proposal would require disclosure of the expense ratio as well as the maximum sales load, separate and apart from the disclosure of standardized performance.

Finally, the rules would provide that, in the case of materials delivered through an electronic medium, the new disclosure requirements may be satisfied by presenting the information required in a manner that is intended to draw investor attention to the disclosures. In the case of radio, television, or video performance advertising, the information required must be given prominence equal to that given to non-standardized performance information, if applicable.

NASD also is proposing an amendment to Rule 2211(d)(1) to reflect that institutional sales material and correspondence also would be subject to these proposed content standards in new Rule 2210(d)(3).

NASD also seeks comment on possible alternatives to the disclosure proposed in this *Notice to Members*. Should the proposal be expanded to require disclosure of other types of information? Instead of disclosure of a fund's expense ratio, should NASD require disclosure of the actual dollar amount of expenses incurred by a hypothetical shareholder in the fund (e.g., dollar amount of expenses per a \$10,000 investment)?

NASD also seeks comment on whether the requirements in the proposal should be extended to certain types of investment company sales material that does not present performance information. For example, in December 1998, NASD notified members that advertisements and sales material that refer to a fund as "no-load" or part of a "no-load" family of funds must disclose the fact that other fees and expenses apply to an investment in the fund and are described in the fund's current prospectus.<sup>5</sup> Would investors be better served if all sales material that refers to a fund as "no-load" were required to disclose the fund's annual expense ratio?

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## Endnotes

- 1 Performance advertising also is subject to the antifraud provisions of the federal securities laws.
- 2 Rule 2210(c)(1). Rule 2210(c)(2) requires that such materials be filed at least ten days *prior* to first use if they include performance rankings or performance comparisons of the fund with other investment companies if the ranking or comparison category is not generally published or is the creation of the fund or a fund affiliate.
- 3 Rule 2211, effective November 3, 2003, was adopted as part of NASD's modernization of its advertising rules earlier this year. See *Notice to Members 03-38*.
- 4 See *2003 Mutual Fund Fact Book*, Investment Company Institute. In contrast, only 6 percent of U.S. households owned funds in 1980.
- 5 *Notice to Members 98-107*.

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## ATTACHMENT A

### TEXT OF PROPOSED AMENDMENTS

Rule 2210 is amended by adding the following new language at the end of paragraph (d):

(d)(3) Standards Applicable to Investment Company Communications with the Public

(A) Communications with the public that include investment company performance data as permitted by Rule 482 under the Securities Act of 1933 and Rule 34b-1 under the Investment Company Act of 1940 must disclose:

- (i) the standardized performance information mandated by Rule 482 and Rule 34b-1;
- (ii) the maximum sales charge imposed on purchases or the maximum contingent deferred sales charge, computed in accordance with Item 3 of Form N-1A under the Investment Company Act of 1940 ("Item 3"); and
- (iii) annual fund operating expenses, computed as a percentage of total net assets in accordance with Item 3, as of the most recent calendar quarter.

(B) The information described in subparagraph (A) must be set forth in:

- (i) a prominent text box that contains only the information required by paragraph (A); and
- (ii) a type size at least as large as that used to present any non-standardized performance.

(C) In a communication delivered through an electronic medium, the requirements of subparagraph (B) may be satisfied by presenting the information in a manner that is intended to draw investor attention to it. In a radio, television or video advertisement, the information must be given emphasis equal to that given to any non-standardized performance information.

Rule 2211(d)(1) is amended as follows (new text is underlined):

(1) All institutional sales material and correspondence are subject to the content standards of Rule 2210(d)(1) and (d)(3) and the applicable Interpretive Materials under Rule 2210.

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## ATTACHMENT B

### Sample Disclosure

"[performance numbers.] These performance numbers reflect the deduction of the fund's maximum [front-end/back-end] sales charge and annual expenses. The fund's current maximum [front-end/back-end] sales charge is \_\_% and the fund's current annual expenses are \_\_% of the fund's net assets.

# Notice to Members

DECEMBER 2003

## SUGGESTED ROUTING

Internal Audit  
Legal and Compliance  
Municipal/Government Securities  
Operations  
Trading and Market Making

## KEY TOPICS

Holiday Trade Date–Settlement Date  
Schedule

INFORMATIONAL

## Trade Date–Settlement Date

### 2004 Trade Date–Settlement Date Schedule

### Martin Luther King, Jr., Day:

#### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market® and the securities exchanges will be closed on Monday, January 19, 2004, in observance of Martin Luther King, Jr., Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Regulation T Date*
January 13	January 16	January 21
14	20	22
15	21	23
16	22	26
19	Markets Closed	—
20	23	27

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## Presidents' Day

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, February 16, 2004, in observance of Presidents' Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Regulation T Date*
February 10	February 13	February 18
11	17	19
12	18	20
13	19	23
16	Markets Closed	—
17	20	24

## Good Friday

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Good Friday, April 9, 2004. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Regulation T Date*
April 5	April 8	April 13
6	12	14
7	13	15
8	14	16
9	Markets Closed	—
12	15	19

## Memorial Day

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, May 31, 2004, in observance of Memorial Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Regulation T Date*
May 25	May 28	June 2
26	June 1	3
27	2	4
28	3	7
31	Markets Closed	—
June 1	4	8

## Independence Day

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, July 5, 2004, in observance of Independence Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Regulation T Date*
June 29	July 2	July 7
30	6	8
July 1	7	9
2	8	12
5	Markets Closed	—
6	9	13

## Labor Day

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, September 6, 2004, in observance of Labor Day. “Regular way” transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Regulation T Date*
August 31	September 3	September 8
Sept 1	7	9
2	8	10
3	9	13
6	Markets Closed	—
7	10	14

## Columbus Day

### Trade Date–Settlement Date Schedule

The schedule of trade dates–settlement dates below reflects the observance by the financial community of Columbus Day, Monday, October 11, 2004. On this day, The Nasdaq Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation’s banking institutions will be closed.

Note: October 11, 2004, is considered a business day for receiving customers’ payments under Regulation T of the Federal Reserve Board. Transactions made on Monday, October 11, will be combined with transactions made on the previous business day, October 8, for settlement on October 14. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on October 11.

Trade Date	Settlement Date	Regulation T Date*
October 5	October 8	October 12
6	12	13
7	13	14
8	14	15
11	14	18
12	15	19

## Veterans' Day And Thanksgiving Day

### Trade Date–Settlement Date Schedule

The schedule of trade dates–settlement dates below reflects the observance of the financial community of Veterans' Day, Thursday, November 11, 2004, and Thanksgiving Day, Thursday, November 25, 2004. On Thursday, November 11, The Nasdaq Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed in observance of Veterans' Day. All securities markets will be closed on Thursday, November 25, 2004, in observance of Thanksgiving Day.

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Note: November 11, 2004, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. Transactions made on November 11 will be combined with transactions made on the previous business day, November 10, for settlement on November 16. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 11.

Trade Date	Settlement Date	Regulation T Date*
November 5	November 10	November 12
8	12	15
9	15	16
10	16	17
11	16	18
12	17	19
19	24	29
22	26	30
23	29	December 1
24	30	2
25	Markets Closed	—
26	December 1	3

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## Christmas Day

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Friday, December 24, 2004, in observance of Christmas Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Regulation T Date*
December 20	December 23	December 28
21	27	29
22	28	30
23	29	31
24	Markets Closed	—
27	30	January 3, 2005

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Brokers, dealers, and municipal securities dealers should use the foregoing settlement dates for purposes of clearing and settling transactions pursuant to the National Association of Securities Dealers, Inc. (NASD®) Uniform Practice Code and the Municipal Securities Rulemaking Board Rule (MSRB) G-12 on Uniform Practice.

Questions regarding the application of those settlement dates to a particular situation may be directed to the Market Integrity Department at (203) 375-9609.

\* Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within five business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column titled "Regulation T Date."

# Notice to Members

DECEMBER 2003

## SUGGESTED ROUTING

Corporate Financing  
Institutional  
Legal & Compliance  
Operations  
Senior Management  
Syndicate  
Trading & Market Making  
Training

## KEY TOPICS

Free-Riding and Withholding  
IPOs  
Issuer Directed Securities  
Restricted Person  
Rule 2790

INFORMATIONAL

## Initial Public Offerings (IPOs)

SEC Approves New Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities); Replaces Free-Riding and Withholding Interpretation; **Voluntary Effective Date: December 23, 2003; Mandatory Effective Date: March 23, 2004**

### Executive Summary

On October 24, 2003, the Securities and Exchange Commission (SEC) approved new Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities), which replaces the Free-Riding and Withholding Interpretation (IM-2110-1).<sup>1</sup> As described in detail below, Rule 2790 generally prohibits a member from selling a "new issue" to any account in which a "restricted person" has a beneficial interest. The term "restricted person" includes most associated persons of a member, most owners and affiliates of a broker/dealer, and certain other classes of persons. The Rule requires that a member, before selling a new issue to any account, meet certain "preconditions for sale," which generally require the member to obtain a representation from the beneficial owner of the account that the account is eligible to purchase new issues in accordance with the Rule. The Rule also contains a series of general exemptions.

In view of the number of significant changes under the Rule, NASD has agreed to provide a three-month transition period in which members and associated persons may comply with either Rule 2790 or the Interpretation. Thus, through the period ending **March 22, 2004**, members and associated persons may comply with either the Rule or the Interpretation. Effective **March 23, 2004**, all members and associated persons must comply with Rule 2790.

03-79

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The SEC Approval Order, which includes the text of the Rule, is available at [http://www.nasdr.com/pdf-text/rf99\\_60\\_app.pdf](http://www.nasdr.com/pdf-text/rf99_60_app.pdf).

## Questions/Further Information

Questions regarding this *Notice* may be directed to Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8104; or Afshin Atabaki, Attorney, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8902.

## Background and Discussion

Rule 2790, like the Free-Riding and Withholding Interpretation (Interpretation) it replaces, is designed to protect the integrity of the public offering process by ensuring that: (1) NASD members make *bona fide* public offerings of securities at the offering price; (2) members do not withhold securities in a public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to members; and (3) industry insiders, including NASD members and their associated persons, do not take advantage of their “insider” position to purchase “new issues” for their own benefit at the expense of public customers. The Rule plays an important part in maintaining investor confidence in the capital raising and public offering process.<sup>2</sup>

Rule 2790 represents a significant restructuring and revision to the Interpretation. While the focus of this *Notice* is on the provisions of new Rule 2790, it is worth noting some of the more significant changes from the Interpretation. First, the Rule eliminates the requirement that an offering must be a “hot issue,” which is defined in the Interpretation as securities of a public offering that trade at a premium in the secondary market whenever such secondary market beings. To avoid some of the problems arising from the fact that members could not always predict whether an offering would be a hot issue, the prohibitions in Rule 2790 apply to all new issues, regardless of whether they commence trading in the secondary market at a premium.

Second, Rule 2790 eliminates the category of “conditionally restricted” persons. Under the Interpretation, persons generally referred to as “conditionally restricted” were eligible to purchase hot issues if certain conditions were met, including that the purchases were in accordance with the purchaser’s “normal investment practice.” NASD Rule 2790 instead more narrowly defines the category of restricted persons, but does not provide exemptions based on a person’s individual circumstances.

Third, Rule 2790 adopts a “*de minimis*” exemption, allowing an account that is beneficially owned in part by restricted persons to purchase new issues if the beneficial interests of such persons do not exceed 10 percent of such account. By contrast, the Interpretation contains no such exemption, and thus even the most minute interests by a restricted person would prohibit an account from purchasing a hot issue unless certain “carve-out” and certification procedures were followed.

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Fourth, the new Rule standardizes the records firms must maintain evidencing that sales to accounts are in accordance with the Rule. The Interpretation imposes varying certification requirements depending on whether an account is, for example, an investment partnership or corporation, a foreign investment company, an account for which a bank or trust company is acting as a conduit, or an account of a foreign broker/dealer (on behalf of non-restricted persons) that is participating in the distribution as an underwriter, etc.). Rule 2790 consolidates the recordkeeping requirements in a single section addressing “preconditions for sale.”

Finally, the Rule eliminates the cancellation provisions. Because the Interpretation applies only to hot issues, and it was not always known whether an offering would be a hot issue, the Interpretation contains a provision allowing a member within a specified time period to cancel an allocation to a restricted person and reallocate such shares to a non-restricted person. In view of the fact that Rule 2790 applies to all new issues, not just those that are “hot,” this provision was deemed unnecessary.

#### **A. General Prohibitions**

Paragraph (a) sets forth the general prohibitions of the Rule. Subparagraph (a)(1) states that a member or a person associated with a member may not sell, or cause to be sold, a new issue to any account in which a restricted person has a beneficial interest, except as otherwise permitted by the Rule. Subparagraph (a)(2) provides that a member or a person associated with a member may not purchase a new issue in any account in which such member or person associated with a member has a beneficial interest, except as otherwise permitted by the Rule. Subparagraph (a)(3) provides that a member may not continue to hold new issues acquired by the member as an underwriter, selling group member,<sup>3</sup> or otherwise, except as permitted by the Rule.

Subparagraph (a)(4) sets for exceptions to the general prohibitions. Subparagraph (a)(4)(A) permits sales or purchases from one member of the selling group to another member that are incidental to the distribution of a new issue to a non-restricted person at the public offering price. Subparagraph (a)(4)(B) permits “accommodation sales”—sales to or purchases by a broker/dealer at the public offering price to enable that broker/dealer’s customer to purchase a new issue at the public offering price. Lastly, subparagraph (a)(4)(C) is designed to exempt purchases by joint back office broker/dealers (“JBOs”<sup>4</sup>) that can fall within the *de minimis* exemption of paragraph (c)(4). NASD believes that the ability of hedge funds registered as JBOs (or with JBO subsidiaries) to purchase new issues should be determined by the status of the beneficial owners of the fund, not simply the fund’s status as a broker/dealer (or owner of a broker/dealer). Accordingly subparagraph (a)(4)(C) exempts purchases of a new issue at the public offering price by a broker/dealer (or owner of a broker/dealer) organized as an investment partnership, provided that such purchases are credited to the capital accounts of its partners in accordance with the provisions of paragraph (c)(4). This provision allows an investment partnership that registers as a broker/dealer, or that has a broker/dealer subsidiary, to purchase new issues on the same terms as other investment partnerships.<sup>5</sup>

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## **B. Preconditions for Sale**

Paragraph (b) provides that a member may not sell new issues to any account unless within the previous 12 months it has in good faith obtained a representation from either (1) the beneficial owners of the account, or a person authorized to represent the beneficial owners of an account, that the account is eligible to purchase new issues in accordance with the Rule, or (2) certain conduits (such as a bank, foreign bank, broker/dealer, or investment adviser) that all purchases of new issues are in compliance with the Rule. Paragraph (b) further provides that a member may not rely upon any representation that it believes, or has reason to believe, is inaccurate. Paragraph (b) also sets forth the recordkeeping provisions applicable to the preconditions for sale.<sup>6</sup>

NASD requires the initial verification of an account's status under the Rule to be a positive affirmation from the beneficial owners, person authorized to act on their behalf, or a conduit. However, as noted in the Approval Order, NASD will permit members to conduct the annual verification of an account's status through the use of negative consent letters. Thus, a member may furnish a customer with account information on record used to determine that the account is eligible to purchase new issues and ask the customer to indicate whether anything has changed to make the account restricted. In the absence of any response from the customer, the member may continue to deem the account as non-restricted. In addition, NASD intends to permit the use of electronic communications in accordance with the standards adopted by the SEC and NASD for the use of such communications (e.g., where appropriate notice has been provided and where necessary customer consent has been obtained). Lastly, however, NASD will not permit members to verify customer account information orally.

During the rulemaking process, some commenters asked what type of representations would be required in a fund-of-funds context. NASD responded that under the Rule, a member only must obtain a representation from a person authorized to represent the beneficial owners of the fund/account that purchases new issues directly from the member ("master fund"). NASD expects, however, that any person making such a representation would need to ascertain the status of investors of any feeder funds that invest in the master fund. If a representative of a master fund is unable to ascertain the status of an investor in a feeder fund, the master fund must deem such feeder fund to be restricted and ensure that any profits from new issues are not allocated to that fund (or consider whether any exemption, such as the *de minimis* exemption, might apply to that feeder fund).

While the Rule specifies that a member must verify the status of the master fund annually, the Rule does not specify a time period during which a master fund may rely on information from a feeder fund. NASD recognizes that logistical impracticalities may prevent all authorized representatives of feeder funds from verifying information at the same time as the representative of the master fund. Thus, NASD will allow the representative of a master fund to rely on information from any feeder fund that is no more than 12 months old. Similarly, the representative of a feeder fund that in turn receives investments from other feeder funds may rely on information that is no more than 12 months old.

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In addition, if a feeder fund is beneficially owned in part by restricted persons and seeks to avail itself of the *de minimis* exemption, the person authorized to represent that fund should specify the percentage ownership by restricted persons. An authorized representative of a master fund that invests directly in new issues will be responsible for aggregating interests of restricted persons from the feeder funds to ensure that the aggregate ownership by restricted persons does not exceed the 10 percent threshold.

### C. General Exemptions

Rule 2790 contains a number of exemptions. Many of the exemptions in the Interpretation have been carried forward into Rule 2790. In some cases, new exemptions have been added, and in others, exemptions have been scaled back or eliminated entirely. The exemptions in Rule 2790 reflect the general proposition that sales to and purchases by entities that have numerous beneficial owners are generally not the type of transactions that the Rule should prohibit. Despite this general unifying theme, NASD emphasizes that it will not be sufficient for a member or purchaser to claim an exemption on the basis that a particular purchase or sale benefits numerous beneficial owners, few if any of whom are restricted persons. To purchase new issues under the Rule, an account otherwise restricted must be covered by a specific exemption under the Rule.

1. Subparagraph (c)(1) exempts from the Rule sales to and purchases by investment companies registered under the Investment Company Act of 1940. This provision is similar to an existing exemption in the Interpretation.
2. Subparagraph (c)(2) exempts sales to and purchases by common trust funds that have investments from 1000 or more accounts and that do not limit interests in the fund principally to trust accounts of restricted persons. This provision is a new exemption.
3. Subparagraph (c)(3) exempts insurance company general, separate, or investment accounts provided that (a) the account is funded by premiums from 1000 or more policyholders, or, if a general account, the insurance company has 1000 or more policyholders; and (b) the insurance company does not limit the policyholders whose premiums are used to fund the account principally to restricted persons, or, if a general account, the insurance company does not limit its policyholders principally to restricted persons. This provision also is a new exemption.
4. Subparagraph (c)(4) establishes the so-called "*de minimis*" exemption. The *de minimis* exemption exempts sales to and purchases by an account if the beneficial interests of restricted persons do not exceed in the aggregate 10 percent of such account. The *de minimis* exemption was created in part to reflect the burden of carving out interests of restricted persons that own only a small portion of a restricted account. NASD believes that allocations to accounts that are owned 90 percent or more by non-restricted persons generally do not present concerns underlying the Rule. While restricted persons may receive

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some benefit from new issues, nearly all of the benefit (90 percent or greater) flows to non-restricted persons. The introduction of a *de minimis* exemption represents a substantial change from the Interpretation, which required all interests of restricted persons to be “carved-out” no matter how small.

In addition, the Rule provides more flexibility concerning the methods of effecting a “carve-out.” In paragraph (g) of the Interpretation, NASD specified the process for “carving-out” interests of restricted persons. Generally, this called for the creation of “separate brokerage accounts.” In administering these procedures, NASD staff observed that not all investment entities (and in particular funds of funds) were established in a manner to accommodate the specific procedures of paragraph (g), even though such accounts could just as effectively ensure that the benefits of IPOs did not reach restricted persons. In Rule 2790, NASD has eliminated specific “carve-out” procedures recognizing that there may be many effective means of segregating interests of restricted persons. Some investors may choose to establish “separate accounts” similar to the provisions of paragraph (g) of the Interpretation. Others instead may maintain one account but adjust the capital accounts of restricted persons to remove any gains (or losses) attributable to new issues.

For purposes of determining the ownership level of restricted persons in a master fund, the interests of restricted persons in a feeder fund shall be attributed to a master fund in an amount equal to the restricted persons’ interest in the feeder fund times the master fund’s interest in the feeder fund. For example, if a master fund has an equal interest in 10 feeder funds, 5 of which are owned 20 percent by restricted persons, and 5 of which are owned 5 percent by restricted persons, the master fund is deemed to be owned 12.5 percent by restricted persons. The interest of the master fund in the each of the 5 funds that are owned 20 percent by restricted persons is determined as follows: 10 percent (the interest of the master fund in the first tier feeder fund) x 20 percent (the interest of the first tier feeder fund in the second tier feeder fund) = 2 percent. With respect to these 5 funds owned by the master fund, the interest of restricted persons in aggregate is 10 percent (5 funds x 2 percent each). The interest of the master fund in the each of the 5 funds that are owned 5 percent by restricted persons is determined as follows: 10 percent (the interest of the master fund in the first tier feeder fund) x 5 percent (the interest of the first tier feeder fund in the second tier feeder fund) = 0.5 percent. With respect to these 5 funds owned by the master fund, the interest of restricted persons is 2.5 percent (5 funds x 0.5 percent each). The total interest of restricted persons in the master fund is 12.5 percent (10 percent + 2.5 percent = 12.5 percent). In this case, the master fund would not be eligible to use the *de minimis* exemption unless it reduced the interest of restricted persons from 12.5 percent to 10 percent or below.

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5. Subparagraph (c)(5) establishes the “publicly traded entity exemption.” Specifically, subparagraph (c)(5) exempts sales to and purchases by publicly traded entities (other than a broker/dealer or an affiliate<sup>7</sup> of a broker/dealer where such broker/dealer is authorized to engage<sup>8</sup> in the public offering of new issues either as a selling group member or underwriter) that are listed on a national securities exchange, are traded on the NASDAQ National Market, or are foreign issuers that meet the quantitative designation criteria for listing on a national securities exchange or the NASDAQ National Market. NASD notes that these entities have broad public ownership and may be purchased by any investor. Moreover, the publicly traded entity exemption recognizes the practical limitations in attempting to identify every beneficial owner, and that the benefits of investments in new issues are, indirectly, shared by the public shareholders.

Thus, a parent company that is publicly traded and has a broker/dealer subsidiary that engages in public offerings would be restricted under paragraph (i)(10)(E) of the Rule and would not qualify for the publicly traded entity exemption. All accounts in which such parent company had a beneficial interest (including entities in which the parent held an interest of 10 percent or more) also would be restricted persons, even if the business of the subsidiaries was wholly unrelated to the broker/dealer activities. By contrast, a publicly traded parent company whose broker/dealer subsidiary does not engage in public offerings of new issues would qualify for the publicly traded entity exemption in paragraph (c)(5) of the Rule. The broker/dealer subsidiary would continue to be a restricted person, but the parent company and other non-restricted subsidiaries of the parent company would be eligible to purchase new issues.

By looking at whether a broker/dealer is authorized to engage in public offerings of new issues, NASD is excluding affiliates of “full service” broker/dealers. On the other hand, Rule 2790 allows purchases of new issues by the many publicly traded entities that may have broker/dealer affiliates for limited corporate purposes. Subparagraph (c)(5) does not extend to a private company, which may avail itself of the *de minimis* exemption in paragraph (c)(4) discussed above.

6. Subparagraph (c)(6) exempts sales to and purchases by foreign investment companies. Specifically, the exemption applies to an investment company organized under the laws of a foreign jurisdiction that is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority, provided that no person owning 5 percent or more of the investment company is a restricted person. This exemption is similar to an existing provision in the Interpretation, but has been streamlined. NASD has eliminated requirements that a foreign investment company have 100 or more investors and limitations on the amount of the fund’s assets that can be invested in a particular security being offered. A foreign investment company that does not meet the conditions of subparagraph (c) may, however, be eligible to purchase new issues under the *de minimis* exemption.

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NASD reminds firms that the foreign investment company exception is intended to extend benefits to foreign investment entities that are similar to U.S. mutual funds. In imposing a requirement that a foreign investment company be "authorized for sale to the public," NASD is attempting to equate to the way registered investment companies are offered in the United States. Foreign investment companies that are limited to high net worth individuals should not be considered "authorized for sale to the public," as a large segment of the foreign public would not be eligible to purchase them.

7. Subparagraph (c)(7) exempts sales to and purchases by an ERISA benefits plan that is qualified under Section 401(a) of the Internal Revenue Code (IRC), provided that such plan is not sponsored solely by a broker/dealer. Thus, a plan sponsored by a broad-based financial services company that includes a broker/dealer subsidiary would be eligible to purchase new issues. The ERISA plan exemption is similar to a provision in the current Interpretation.
8. Subparagraph (c)(8) exempts sales to and purchases by a state or municipal government plans that is subject to state and/or municipal regulation. This exemption reflects the fact that purchases of new issues by government and municipal plans, while not qualified under ERISA, do not raise concerns under the Rule.
9. Subparagraph (c)(8) exempts sales to and purchases by a tax-exempt charity organized under Section 501(c)(3) of the IRC. NASD believes that sales of new issues to these charities are consistent with the purposes of the Rule and foster a bona fide public distribution.
10. Subparagraph (c)(10) exempts sales to and purchases by church plans described in Section 414(e) of the IRC. Church plans, which are operated for the benefit of employees of a church or a convention or association of churches, are similar to other ERISA plans, but are not qualified under Section 401(a) of the IRC. NASD finds that the rationale for exempting ERISA plans qualified under Section 401(a) of the IRC applies equally to church plans as defined under Section 414(e) of the IRC.

**D. Issuer-Directed Securities**

Paragraph (d) addresses issuer-directed securities. Subparagraph (d)(1) exempts, for most purchasers, securities that are specifically directed by the issuer. The issuer-directed exemption for sales to and purchases by persons who are broker/dealer personnel, as defined in subparagraph (i)(10)(B), and finders and fiduciaries, as defined in subparagraph (i)(10)(C), applies only if such persons, or a member of their immediate family, is an employee or director of the issuer, the issuer's parent, or a subsidiary of the issuer or the issuer's parent.<sup>9</sup> Unlike the Interpretation, the Rule 2790 issuer-directed exemption does not require that issuer-directed securities be subject to a three-month lock-up. NASD also believes that the issuer-directed exemption should apply only when shares are in fact directed by an issuer. Thus, members should not seek to circumvent

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prohibitions of the Rule by seeking to have issuers direct securities to restricted persons on their behalf. NASD also will continue its practice of holding a managing underwriter responsible for ensuring that all issuer-directed securities are distributed in accordance with the Rule.

Subparagraph (d)(2) creates an exemption for securities distributed as part of a program sponsored by the issuer, or an affiliate of the issuer, that meets four conditions: (1) the opportunity to purchase a new issue under the program is offered to at least 10,000 participants; (2) every participant is offered an opportunity to purchase an equivalent number of shares or will receive a specified number of shares under a predetermined formula applied uniformly across all participants; (3) if not all participants receive shares under the program, the selection of the eligible participants is based on a random or other non-discretionary allocation method; and (4) the class of participants does not contain a disproportionate number of restricted persons.<sup>10</sup> This exemption codifies the NASD staff position taken in several exemptive letters under the Interpretation.

Subparagraph (d)(3) exempts new issues directed to eligible purchasers as part of a conversion offering<sup>11</sup> conducted in accordance with the standards of the governmental agency or instrumentality having authority to regulate such conversion offering. This exemption is similar to an exemption in the Interpretation.

#### **E. Anti-Dilution Provisions**

Paragraph (e) of the Rule contains “anti-dilution” provisions. This provision permits a restricted person that is an existing equity owner of an issuer to purchase shares of the issuer in a public offering in order to maintain its equity ownership position. A restricted person seeking an exemption under this provision must meet the following criteria: (1) the account has held an equity ownership interest in the issuer for a period of one year prior to the effective date of the offering; (2) the sale of the new issue to the account does not increase the account’s percentage equity ownership in the issuer above the ownership level as of three months prior to the filing of the registration statement in connection with the offering; (3) the sale of the new issue to the account does not include any special terms; and (4) the new issue purchased pursuant to this exemption is not sold or transferred for three months following the effective date of the offering. Paragraph (e) replaces the substantially similar “Venture Capital Investors” exemption of the Interpretation.

#### **F. Stand-By Purchasers**

Paragraph (f) of the Rule contains an exemption for stand-by purchasers. Specifically, paragraph (f) provides that the prohibitions on the purchase and sale of new issues do not apply to purchases and sales made pursuant to a stand-by agreement that meets the following four conditions: (1) the stand-by agreement is disclosed in the prospectus; (2) the stand-by agreement is the subject of a formal written agreement; (3) the managing underwriter represents in writing that it is unable to find any other

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purchasers for the securities; and (4) securities sold pursuant to the stand-by agreement are subject to a three-month lock-up period. Paragraph (f) is substantively similar to a provision in the Interpretation.

**G. Under-Subscribed Offerings**

Paragraph (g) permits an underwriter, pursuant to an underwriting agreement, to retain a portion of an offering of a new issue in its investment account if it is unable to sell that portion to the public. This is a new provision that became necessary as a result of the change in the Rule to apply to all new issues, not just those that were hot issues. Because the Rule applies to all new issues, even those for which they may not be sufficient demand, the Rule permits an underwriter to place unsold shares into its investment account. Members should be aware that this provision does not permit a member to place unsold shares into an account of another restricted person. Members are not permitted to place unsold shares into an account beneficially owned by restricted persons (other than an investment account of the member) because the net effect of such a provision would be akin to a hot issue standard (equating lack of demand with a flat or lower opening price in the secondary market), which the Rule seeks to abandon.

**H. Exemptive Relief**

Paragraph (h) provides the staff with the authority to grant an exemption for any or all of the provisions of the Rule if it determines that such exemption is consistent with the purposes of the Rule, the protection of investors, and the public interest. The exemptive authority under Rule 2790 is similar to the exemptive authority in the Interpretation. Consistent with guidance from SEC staff, NASD intends to use its exemptive authority only in circumstances that are “truly unique.”<sup>12</sup>

**I. Definitions of Key Terms**

**1. *Beneficial Interest***

Subparagraph (i)(1) defines the term “beneficial interest” as any economic interest, such as the right to share in gains and losses. Consistent with a previously articulated position under the Interpretation, the definition of “beneficial interest” excludes the receipt of a management or performance-based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity. The definition of “beneficial interest” differs from the definition in the Interpretation in that beneficial interest no longer includes solely a legal interest.

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NASD offers the following guidance with respect to a performance-based fee that is deferred for tax or other purposes. The *initial* receipt of a performance-based fee would not constitute a beneficial interest in a collective account. However, the accumulation of these payments, if *subsequently* invested in the collective investment account (as a deferred fee arrangement or otherwise) would constitute a beneficial interest in the account.

### 2. *Collective Investment Account*

Subparagraph (i)(2) defines the term “collective investment account” as any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle that is engaged primarily in the purchase and/or sale of securities. As part of the reforms of Rule 2790, a collective investment account does not include a “family investment vehicle” or an “investment club.” Each of these terms is separately defined in the Rule.

### 3. *Immediate Family Member*

Several of the definitions of the term “restricted person” are extended to certain immediate family members. Subparagraph (i)(5) defines “immediate family member” as a person’s parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children. Additionally, “immediate family member” includes any other individual to whom the person provides material support. This definition is substantively identical to the definition contained in the Interpretation.

### 4. *Material Support*

As noted above, several of the definitions of the term “restricted person” are extended to immediate family members that receive “material support” from a restricted person, or that provide “material support” to a restricted person. While the term “material support” was also used in the Interpretation, it was not a defined term. Rule 2790 defines the term as directly or indirectly providing more than 25 percent of a person’s income in the prior calendar year. In addition, members of the immediate family living in the same household are deemed to be providing each other with “material support.”

### 5. *New Issue*

Subparagraph (i)(9) defines the term “new issue” as any initial public offering of an equity security as defined in Section 3(a)(11) of the Securities Exchange Act of 1934, made pursuant to a registration statement or offering circular. Application of the Rule to all “new issues,” rather than just those that are “hot issues,” represents one of the most significant changes between Rule 2790 and the Interpretation. As the foregoing definition suggests, the Rule does not apply to secondary offerings. Similarly, the foregoing definition excludes offerings of debt securities.

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Furthermore, in view of the broader definition encompassed by the term “new issue,” subparagraph (i)(9) expressly excludes other types of offerings. Subparagraph (i)(9)(A) excludes various private offerings. Subparagraph (i)(9)(B) excludes offerings of exempted securities. Subparagraph (i)(9)(C) excludes offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act. Subparagraph (i)(9)(D) excludes rights offerings, exchange offerings, or offerings made pursuant to a merger or acquisition. Subparagraph (i)(9)(E) excludes offerings of investment grade asset-backed securities. NASD believes that the exclusion for investment grade asset-backed securities is necessary because certain asset-backed securities may be considered equity rather than debt securities. Subparagraphs (i)(9)(F) and (G) exclude offerings of convertible and preferred securities, respectively. Subparagraph (i)(9)(H) excludes offerings of securities of an investment company registered under the Investment Company Act of 1940. Lastly, subparagraph (i)(9)(I) excludes offerings of securities (in ordinary form or ADRs registered on Form F-6) that have a pre-existing market outside of the United States. This exemption in subparagraph (i)(9)(I) applies only to initial offerings of ADRs that are not part of a global initial public offering.<sup>13</sup>

In administering the Interpretation, NASD staff occasionally was asked if it was permissible to allow journal entries between the accounts of non-restricted persons and restricted persons when an offering was no longer a hot issue. Historically, NASD did not view the Interpretation as permitting journaling of hot issues from one account to another. In administering Rule 2790, NASD does not intend to require an outright purchase and sale of a new issue to transfer ownership interests (and risks) to restricted persons. NASD believes that it would be appropriate for firms to allow restricted persons to share in the subsequent gains and losses from new issues provided that restricted persons’ “purchase” of a new issue is not at the IPO price, but at the prevailing market price at the time their capital account reflects ownership of the security.

#### 6. *Restricted Person*

The definition of “restricted person” covers five basic categories. Subparagraph (i)(10)(A) defines the term to include members or other broker/dealers. Subparagraph (i)(10)(B) defines the term to include broker/dealer personnel. Specifically, subparagraph (i)(10)(B)(i) extends the definition of restricted person to include any officer, director, general partner, associated person, or employee of a member or any other broker/dealer (other than a limited business broker/dealer).<sup>14</sup> Subparagraph (i)(10)(B)(ii) provides that agents of a member or any other broker/dealer (other than a limited business broker/dealer) are restricted persons if they are engaged in the investment banking or securities business. Subparagraph (i)(10)(B)(iii) treats as a restricted person an immediate family member of a person specified in subparagraphs (B)(i) or (B)(ii) above, if that person: (a) materially supports or receives support from the immediate family member; (b) is employed by or associated with the member, or an affiliate of the member, selling the new issue to the immediate family member; or (c) has an ability to control the allocation of the issue.

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Subparagraph (i)(10)(C)(ii) treats finders and fiduciaries as restricted persons. Specifically, a restricted person includes, with respect to the security being offered, a finder or any person acting in a fiduciary capacity to the managing underwriter, including, but not limited to, attorneys, accountants, and financial consultants. The Rule also treats as a restricted person an immediate family member of a finder or fiduciary if the finder or fiduciary materially supports, or receives support from, the immediate family member. The provisions addressing finders and fiduciaries are similar to provisions in the Interpretation, but narrower in that they are limited to finders and fiduciaries in the particular offering.

Subparagraph (i)(10)(D) treats portfolio managers as restricted persons. As noted above, one of the more significant changes under the new Rule is the elimination of the “conditionally restricted” status. Rule 2790 defines as a restricted person any person who has the authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account. Although such persons are deemed to be restricted persons under the Rule, this category is substantially narrower than a similar category in the Interpretation in that it is based upon a person’s activities rather than just his or her status as a “senior officer” or a person in a securities department. This definition applies to natural as well as non-natural persons. Similar to the other definitions of restricted person, an immediate family member of a portfolio manager as defined in subparagraph (i)(10)(D)(i) that materially supports, or receives material support from, the portfolio manager, also is a restricted person. One notable change between Rule 2790 and the Interpretation is that a person who has authority to buy or sell securities for an investment club or a family investment vehicle is no longer deemed to be a restricted person based solely upon that investment authority.

Subparagraph (i)(10)(E) addresses owners of broker/dealers. NASD believes that the prohibition on purchases of new issues by a broker/dealer could be circumvented if the owners of a broker/dealer were permitted to purchase the new issue. Consequently, NASD has drafted the definition of restricted person to include owners of broker/dealers. Subparagraph (i)(10)(E)(i) captures direct owners by treating as a restricted person any person listed, or required to be listed, on Schedule A of Form BD<sup>15</sup> (other than with respect to a limited business broker/dealer), except persons identified by an ownership code of less than 10 percent. Subparagraph (i)(10)(E)(ii) captures indirect owners by treating as a restricted person any person listed, or required to be listed, on Schedule B of Form BD,<sup>16</sup> except persons whose listing on Schedule B relates to an ownership interest in a person listed on Schedule A identified by an ownership code of less than 10 . In addition, as Schedules A and B are used in connection with an initial application to become a broker/dealer, subparagraph (i)(10)(E)(iii) includes in the definition of restricted person any person listed, or required to be listed, on Schedule C of Form BD that meets the criteria of subparagraphs (i)(10)(E)(i) and (ii) above.

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In general, Schedules A and B do not require reporting of direct or indirect owners of “public reporting companies.” However, persons owning significant concentrations of such persons may implicate the concerns the Rule is designed to address. Accordingly, subparagraphs (i)(10)(E)(iv) and (v) sweep in owners, above specified thresholds, of a public reporting company (other than a public reporting company that is listed on a national securities exchange or traded on the NASDAQ National Market). Owners of public reporting companies listed on a national securities exchange or traded on the NASDAQ National Market are excluded for reasons similar to those underlying the publicly traded entity exemption. Lastly, subparagraph (i)(10)(E)(vi) treats as a restricted person a member of the immediate family of a person specified in subparagraphs (i)(10)(E)(i)-(v) unless the person owning the broker/dealer: (a) does not materially support, or receive material support from, the immediate family member; (b) is not an owner of the member, or an affiliate of the member, selling the new issue to the immediate family member; and (c) has no ability to control the allocation of the new issue.

Finally, as noted above, pursuant to paragraph (a)(1), a member or an associated person may not sell a new issue to any account in which a restricted person has a beneficial interest. This provision precludes, absent an exemption, sales of new issues to accounts in which an owner of a broker/dealer has a beneficial interest, including subsidiaries of the broker/dealer. NASD believes that applying the Rule to subsidiaries and other accounts is necessary to prevent a restricted person from evading the restriction by directing a subsidiary to purchase a new issue on its behalf. The application of this provision in combination with the publicly traded entity exemption would, nevertheless, permit a subsidiary to purchase new issues if the owner of the subsidiary is eligible to purchase new issues under the publicly traded entity exemption as discussed above. Further, the restriction would not apply to a subsidiary that independently qualifies for any other exemption under the Rule (e.g., if the subsidiary is a tax-exempt charity organized under Section 501(c)(3) of the IRC). In addition, a subsidiary that is beneficially owned in part by restricted persons is eligible to use the *de minimis* exemption.

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## Effective Date

In view of the number of significant changes in Rule 2790, and in response to comments raised during the rulemaking process, NASD has agreed to allow a three-month transition period in which members may comply with either Rule 2790 or the Interpretation. NASD believes that allowing members the option to continue to comply with the Interpretation for an additional three months will allow those firms sufficient time to develop the necessary procedures and obtain the necessary customer representations to comply with Rule 2790. Moreover, during this time, members and associated persons may choose to comply with either the Interpretation or Rule 2790 on an account-by-account basis. However, we note that once a member chooses to comply with Rule 2790 rather than the Interpretation, it must ensure that all representations relied upon are in conformity with the provisions of Rule 2790 (*i.e.*, certifications made under the Interpretation, including those on behalf of investment partnerships under paragraph (f) will no longer be valid as the definitions of restricted persons has changed.) Effective **March 23, 2004**, all members and associated persons must comply with Rule 2790.

## Endnotes

- 1 SEC Order Approving Proposed Rule Change and Amendments Nos. 1 Through 4 Thereto and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 5 Thereto by the NASD Relating to Restrictions on the Purchase and Sale of Initial Public Offerings of Equity Securities, 61 Fed. Reg. 62126 (October 31, 2003) ("Approval Order") (File No. SR-NASD-99-60). See also Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. to Interpret Two Provisions of New NASD Rule 2790 Relating to Initial Public Offerings, Release No. 34-48973 (December 22, 2003) (File No. SR-NASD-2003-190).
- 2 Compliance with Rule 2790 does not obviate the need for firms that agreed to the Voluntary Initiative Regarding Allocations of Securities in "Hot" Initial Public Offerings to Corporate Executives and Directors to comply with its terms.
- 3 The term selling group is defined in NASD Rule 0210(p).
- 4 Certain hedge funds, or subsidiaries thereof, elect to become registered broker/dealers and share a back-office with another broker/dealer. These entities are called JBOs.
- 5 Paragraph (a)(4)(C) refers specifically to "investment partnership" because we understand this is the most common organizational form of JBO hedge funds. We believe, however, that the decision to organize as a limited liability company, or some other corporate form, should not undermine the relief granted to hedge funds organized as JBOs or with JBO subsidiaries.

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- 6 None of the preconditions for sale require certification by an attorney or accountant. Certain provisions of the Interpretation (e.g., paragraphs (f) and (g)) require a written representation from an attorney or accountant, but NASD has not continued to make this a condition in Rule 2790.
  - 7 For purposes of this provision, "affiliate" has the same meaning as in NASD Rules 2710 and 2720.
  - 8 Under NASD rules, a member that seeks authority to engage in public offerings must make that part of its membership application. If an existing member that is not authorized to engage in public offerings seeks to do so in the future, such member must make application under NASD Rule 1017. Application of this provision in Rule 2790 will depend on whether a firm is authorized to engage in the public offering of new issues, not whether it actually conducts such offerings. Thus, information in Item 12 of Form BD will not be conclusive of whether a firm is authorized to engage in public offerings, because a member is not required to list on Item 12 activity if it is less than 1 percent of annual revenue. If a firm indicates on Item 12 of Form BD that it is engaged as an underwriter or selling group member, affiliates of such firms cannot purchase new issues.
  - 9 For purposes of this provision, a parent/subsidiary relationship is established if the parent has the right to vote 50 percent or more of a class of voting security of the subsidiary, or has the power to sell or direct 50 percent or more of a class of voting security of the subsidiary.
  - 10 This condition is designed to ensure that a program is not directed to a group composed to a significant extent of restricted persons.
  - 11 "Conversion offering" means any offering of securities made as part of a plan by which a savings and loan association, insurance company, or other organization converts from a mutual to a stock form of ownership.
  - 12 Approval Order, 68 *Fed. Reg.* at 62143.
  - 13 The definition of "new issue" is not limited to domestic securities offerings. Thus, the prohibitions in paragraph (a) of the Rule apply members and their associated persons with respect to foreign offerings.
  - 14 A limited business broker/dealer is defined as a broker/dealer whose authorization to engage in the securities business is limited solely to the purchase and sale of investment company/variable contracts securities and direct participation program securities. This definition is very similar to the definition in the Interpretation, but focuses on whether a firm is authorized to engage in a particular activity rather than on whether it engages in such activity.
  - 15 Schedule A is used by an applicant to list direct owners and executive officers in connection with an initial application to become a broker/dealer.
  - 16 Schedule B is used by an applicant to list indirect owners in connection with an initial application to become a broker/dealer.

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## ATTACHMENT A

Additions are underlined; deletions are in brackets.

### IM-2110-1. ["Free-Riding and Withholding"]

Deleted in its entirety and replaced with:

Reserved.

\* \* \*

### IM-2750. Transactions with Related Persons

A member who is acting, or plans to act, as sponsor of a unit investment trust will not violate Rule 2750 if it accumulates securities with respect to which the member has acted as a syndicate member, selling group member or reallowance dealer in an account of the member or related person of the member if, at the time of accumulation, the member in good faith intends to deposit the securities into the unit investment trust at the public offering price and intends to make a bona fide public offering of the participation units of that trust. Members engaged in such activity, however, will continue to be subject to Rule 2790. [IM-2110-1, "Free-Riding and Withholding."]

\* \* \*

### 2790. Restrictions on the Purchase and Sale of Initial Equity Public Offerings

#### (a) General Prohibitions

(1) A member or a person associated with a member may not sell, or cause to be sold, a new issue to any account in which a restricted person has a beneficial interest, except as otherwise permitted herein.

(2) A member or a person associated with a member may not purchase a new issue in any account in which such member or person associated with a member has a beneficial interest, except as otherwise permitted herein.

(3) A member may not continue to hold new issues acquired by the member as an underwriter, selling group member, or otherwise, except as otherwise permitted herein.

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(4) Nothing in this paragraph (a) shall prohibit:

(A) sales or purchases from one member of the selling group to another member of the selling group that are incidental to the distribution of a new issue to a non-restricted person at the public offering price; [or]

(B) sales or purchases by a broker/dealer of a new issue at the public offering price as part of an accommodation to a non-restricted person customer of the broker/dealer; or

(C) purchases by a broker/dealer (or owner of a broker/dealer), organized as an investment partnership, of a new issue at the public offering price, provided such purchases are credited to the capital accounts of its partners in accordance with paragraph (c)(4).

**(b) Preconditions for Sale**

Before selling a new issue to any account, a member must in good faith have obtained within the twelve months prior to such sale, a representation from:

**(1) Beneficial Owners**

the account holder(s), or a person authorized to represent the beneficial owners of the account, that the account is eligible to purchase new issues in compliance with this rule; or

**(2) Conduits**

a bank, foreign bank, broker/dealer, or investment adviser, or other conduit that all purchases of new issues are in compliance with this rule.

A member may not rely upon any representation that it believes, or has reason to believe, is inaccurate. A member shall maintain a copy of all records and information relating to whether an account is eligible to purchase new issues in its files for at least three years following the member's last sale of a new issue to that account.

**(c) General Exemptions**

The general prohibitions in paragraph (a) of this rule shall not apply to sales to and purchases by the following accounts or persons, whether directly or through accounts in which such persons have a beneficial interest:

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(1) An investment company registered under the Investment Company Act of 1940;

(2) A common trust fund or similar fund as described in Section 3(a)(12)(A)(iii) of the Act, provided that:

(A) the fund has investments from 1,000 or more accounts; and

(B) the fund does not limit beneficial interests in the fund principally to trust accounts of restricted persons;

(3) An insurance company general, separate or investment account, provided that:

(A) the account is funded by premiums from 1,000 or more policyholders, or, if a general account, the insurance company has 1,000 or more policyholders; and

(B) the insurance company does not limit the policyholders whose premiums are used to fund the account principally to restricted persons, or, if a general account, the insurance company does not limit its policyholders principally to restricted persons;

(4) An account if the beneficial interests of restricted persons do not exceed in the aggregate 10% of such account;

(5) A publicly traded entity (other than a broker/dealer or an affiliate of a broker/dealer where such broker/dealer is authorized to engage in the public offering of new issues either as a selling group member or underwriter) that:

(A) is listed on a national securities exchange;

(B) is traded on the Nasdaq National Market; or

(C) is a foreign issuer whose securities meet the quantitative designation criteria for listing on a national securities exchange or trading on the Nasdaq National Market;

(6) An investment company organized under the laws of a foreign jurisdiction, provided that:

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(A) the investment company is listed on a foreign exchange or authorized for sale to the public by a foreign regulatory authority; and

(B) no person owning more than 5% of the shares of the investment company is a restricted person;

(7) An Employee Retirement Income Security Act benefits plan that is qualified under Section 401(a) of the Internal Revenue Code, provided that such plan is not sponsored solely by a broker/dealer;

(8) A state or municipal government benefits plan that is subject to state and/or municipal regulation;

(9) A tax exempt charitable organization under Section 501(c)(3) of the Internal Revenue Code; or

(10) A church plan under Section 414(e) of the Internal Revenue Code.

**(d) Issuer-Directed Securities**

The prohibitions on the purchase and sale of new issues in this rule shall not apply to securities that:

(1) are specifically directed by the issuer to persons that are restricted under the rule; provided, however, that securities directed by an issuer may not be sold to or purchased by an account in which any restricted person specified in subparagraphs (i)(10)(B) or (i)(10)(C) of this rule has a beneficial interest, unless such person, or a member of his or her immediate family, is an employee or director of the issuer, the issuer's parent, or a subsidiary of the issuer or the issuer's parent. Also, for purposes of this paragraph (d)(1) only, a parent/subsidiary relationship is established if the parent has the right to vote 50% or more of a class of voting security of the subsidiary, or has the power to sell or direct 50% or more of a class of voting security of the subsidiary;

(2) are part of a program sponsored by the issuer or an affiliate of the issuer that meets the following criteria:

(A) the opportunity to purchase a new issue under the program is offered to at least 10,000 participants;

(B) every participant is offered an opportunity to purchase an equivalent number of shares, or will receive a specified number of shares under a predetermined formula applied uniformly across all participants;

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(C) if not all participants receive shares under the program, the selection of the participants eligible to purchase shares is based upon a random or other non-discretionary allocation method; and

(D) the class of participants does not contain a disproportionate number of restricted persons as compared to the investing public generally; or

(3) are directed to eligible purchasers who are otherwise restricted under the rule as part of a conversion offering in accordance with the standards of the governmental agency or instrumentality having authority to regulate such conversion offering.

**(e) Anti-Dilution Provisions**

The prohibitions on the purchase and sale of new issues in this rule shall not apply to an account in which a restricted person has a beneficial interest that meets the following conditions:

(1) the account has held an equity ownership interest in the issuer, or a company that has been acquired by the issuer in the past year, for a period of one year prior to the effective date of the offering;

(2) the sale of the new issue to the account shall not increase the account's percentage equity ownership in the issuer above the ownership level as of three months prior to the filing of the registration statement in connection with the offering;

(3) the sale of the new issue to the account shall not include any special terms; and

(4) the new issue purchased pursuant to this paragraph (e) shall not be sold, transferred, assigned, pledged or hypothecated for a period of three months following the effective date of the offering.

**(f) Stand-by Purchasers**

The prohibitions on the purchase and sale of new issues in this rule shall not apply to the purchase and sale of securities pursuant to a stand-by agreement that meets the following conditions:

(1) the stand-by agreement is disclosed in the prospectus;

(2) the stand-by agreement is the subject of a formal written agreement;

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(3) the managing underwriter(s) represents in writing that it was unable to find any other purchasers for the securities; and

(4) the securities sold pursuant to the stand-by agreement shall not be sold, transferred, assigned, pledged or hypothecated for a period of three months following the effective date of the offering.

**(g) Under-Subscribed Offerings**

Nothing in this rule shall prohibit an underwriter, pursuant to an underwriting agreement, from placing a portion of a public offering in its investment account when it is unable to sell that portion to the public.

**(h) Exemptive Relief**

Pursuant to the Rule 9600 series, the staff, for good cause shown after taking into consideration all relevant factors, may conditionally or unconditionally exempt any person, security or transaction (or any class or classes of persons, securities or transactions) from this rule to the extent that such exemption is consistent with the purposes of the rule, the protection of investors, and the public interest.

**(i) Definitions**

(1) "Beneficial interest" means any economic interest, such as the right to share in gains or losses. The receipt of a management or performance based fee for operating a collective investment account, or other fees for acting in a fiduciary capacity, shall not be considered a beneficial interest in the account.

(2) "Collective investment account" means any hedge fund, investment partnership, investment corporation, or any other collective investment vehicle that is engaged primarily in the purchase and/or sale of securities. A "collective investment account" does not include a "family investment vehicle" or an "investment club."

(3) "Conversion offering" means any offering of securities made as part of a plan by which a savings and loan association, insurance company, or other organization converts from a mutual to a stock form of ownership.

(4) "Family investment vehicle" means a legal entity that is beneficially owned solely by immediate family members.

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(5) “Immediate family member” means a person’s parents, mother-in-law or father-in-law, spouse, brother or sister, brother-in-law or sister-in-law, son-in-law or daughter-in-law, and children, and any other individual to whom the person provides material support.

(6) “Investment club” means a group of friends, neighbors, business associates, or others that pool their money to invest in stock or other securities and are collectively responsible for making investment decisions.

(7) “Limited business broker/dealer” means any broker/dealer whose authorization to engage in the securities business is limited solely to the purchase and sale of investment company/variable contracts securities and direct participation program securities.

(8) “Material support” means directly or indirectly providing more than 25% of a person’s income in the prior calendar year. Members of the immediate family living in the same household are deemed to be providing each other with material support.

(9) “New issue” means any initial public offering of an equity security as defined in Section 3(a)(11) of the Act, made pursuant to a registration statement or offering circular. New issue shall not include:

(A) offerings made pursuant to an exemption under Section 4(1), 4(2) or 4(6) of the Securities Act of 1933, or SEC Rule 504 if the securities are “restricted securities” under SEC Rule 144(a)(3), or Rule 144A or Rule 505 or Rule 506 adopted thereunder;

(B) offerings of exempted securities as defined in Section 3(a)(12) of the Act, and rules promulgated thereunder;

(C) offerings of securities of a commodity pool operated by a commodity pool operator as defined under Section 1a(5) of the Commodity Exchange Act;

(D) rights offerings, exchange offers, or offerings made pursuant to a merger or acquisition;

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- (E) offerings of investment grade asset-backed securities;  
(F) offerings of convertible securities;  
(G) offerings of preferred securities;  
(H) offerings of an investment company registered under the Investment Company Act of 1940; and  
(I) offerings of securities (in ordinary share form or ADRs registered on Form F-6) that have a pre-existing market outside of the United States.
- (10) “Restricted person” means:

**(A) Members or other broker/dealers;**

**(B) Broker/Dealer Personnel**

(i) Any officer, director, general partner, associated person, or employee of a member or any other broker/dealer (other than a limited business broker/dealer);

(ii) Any agent of a member or any other broker/dealer (other than a limited business broker/dealer) that is engaged in the investment banking or securities business; or

(iii) An immediate family member of a person specified in subparagraph (B)(i) or (ii) if the person specified in subparagraph (B)(i) or (ii):

a. materially supports, or receives material support from, the immediate family member;

b. is employed by or associated with the member, or an affiliate of the member, selling the new issue to the immediate family member; or

c. has an ability to control the allocation of the new issue.

**(C) Finders and Fiduciaries**

(i) With respect to the security being offered, a finder or any person acting in a fiduciary capacity to the managing underwriter,

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including, but not limited to, attorneys, accountants and financial consultants; and

(ii) An immediate family member of a person specified in subparagraph (C)(i) if the person specified in subparagraph (C)(i) materially supports, or receives material support from, the immediate family member.

**(D) Portfolio Managers**

(i) Any person who has authority to buy or sell securities for a bank, savings and loan institution, insurance company, investment company, investment advisor, or collective investment account.

(ii) An immediate family member of a person specified in subparagraph (D)(i) that materially supports, or receives material support from, such person.

**(E) Persons Owning a Broker/Dealer**

(i) Any person listed, or required to be listed, in Schedule A of a Form BD (other than with respect to a limited business broker/dealer), except persons identified by an ownership code of less than 10%;

(ii) Any person listed, or required to be listed, in Schedule B of a Form BD (other than with respect to a limited business broker/dealer), except persons whose listing on Schedule B relates to an ownership interest in a person listed on Schedule A identified by an ownership code of less than 10%;

(iii) Any person listed, or required to be listed, in Schedule C of a Form BD that meets the criteria of subparagraphs (E)(i) and (E)(ii) above;

(iv) Any person that directly or indirectly owns 10% or more of a public reporting company listed, or required to be listed, in Schedule A of a Form BD (other than a reporting company that is listed on a national securities exchange or is traded on the Nasdaq

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National Market, or other than with respect to a limited business broker/dealer);

(v) Any person that directly or indirectly owns 25% or more of a public reporting company listed, or required to be listed, in Schedule B of a Form BD (other than a reporting company that is listed on a national securities exchange or is traded on the Nasdaq National Market, or other than with respect to a limited business broker/dealer).

(vi) An immediate family member of a person specified in subparagraphs (E)(i)-(v) unless the person owning the broker/dealer:

a. does not materially support, or receive material support from, the immediate family member;

b. is not an owner of the member, or an affiliate of the member, selling the new issue to the immediate family member; and

c. has no ability to control the allocation of the new issue.

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### **3040. Private Securities Transactions of an Associated Person**

(a) through (d) No Change.

#### **(e) Definitions**

For purposes of this Rule, the following terms shall have the stated meanings:

(1) "Private securities transaction" shall mean any securities transaction outside the regular course or scope of an associated person's employment with a member, including, though not limited to, new offerings of securities which are not registered with the Commission, provided however that transactions subject to the notification requirements of Rule 3050, transactions among immediate family members (as defined in Rule 2790 [IM-2110-1, Free-Riding and Withholding]), for which no associated person receives any selling compensation, and personal transactions in investment company and variable annuity securities, shall be excluded.

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## 9600. PROCEDURES FOR EXEMPTIONS

### 9610. Application

#### (a) Where to File

A member seeking an exemption from Rule 1021, 1022, 1070, 2210, 2320, 2340, 2520, 2710, 2720, 2790, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3210, 3350, 8211, 8212, 8213, 11870, or 11900, [Interpretive Material 2110-1,] or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of the Association and provide a copy of the application to the Office of General Counsel of NASD Regulation.

# Notice to Members

DECEMBER 2003

## SUGGESTED ROUTING

Finance  
Legal and Compliance  
Operations  
Senior Management  
Systems

## KEY TOPICS

Late Payments

## ACTION REQUIRED

### NASDAQ Announces New Service Termination Policy Effective January 1, 2004

#### Background

Effective January 1, 2004, The Nasdaq Stock Market, Inc. (NASDAQ) will implement a new service termination policy for members, issuers, and other market participants that are not current in their payments to NASDAQ for any services, including transaction, data, listing, or other services. Under the new policy, NASDAQ will terminate services for any firm that is more than 90 days delinquent in its payments to NASDAQ.

Any firm that is 90 days delinquent on January 1, 2004, or becomes 90 days delinquent between January 1 and January 31, 2004, will have a transition period until February 16, 2004, to become current and resolve any billing disputes with NASDAQ. If a firm is not delinquent in all accounts—e.g., the firm is current in paying for transaction services but delinquent in paying for data services—then NASDAQ will, to the extent possible, terminate only those services for which the firm is more than 90 days delinquent. The 90-day period is measured from the date of the invoice.

NASDAQ is implementing this policy to ensure that it applies its SEC-approved fee schedules in a fair and even-handed manner, consistent with NASDAQ's obligations under Section 15A of the Securities Exchange Act of 1934, as amended. NASDAQ continues to reserve its rights to terminate services as otherwise permitted under any applicable contracts or NASD rules.

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## Questions/Further Information

Questions regarding this policy may be directed to Mary Dunbar, Office of General Counsel, NASDAQ, at (202) 912-3033; Peter Geraghty, Office of General Counsel, NASDAQ, at (202) 912-3036; or John Yetter, Office of General Counsel, NASDAQ, at (202) 912-3039.

Questions regarding an invoice or overdue payment to NASDAQ may be directed to NASDAQ Finance at (800) 955-3898.

# Notice to Members

DECEMBER 2003

## SUGGESTED ROUTING

Continuing Education  
Legal & Compliance  
Registration  
Senior Management

## KEY TOPICS

Regulatory Element

INFORMATIONAL

## Continuing Education

Regulatory Element of Continuing Education Fee to be Reduced from \$65 to \$60; **Effective Date: January 1, 2004**

### Executive Summary

Effective January 1, 2004, the fee for the Regulatory Element of Continuing Education will be reduced from \$65 to \$60. The fee reduction applies to all three Regulatory Element programs: the S201 for Supervisors, the S106 for Series 6 Representatives, and the S101 General Program for all other registrations. Firms that participate in in-firm delivery of the Regulatory Element will continue to receive a \$3 credit to their CRD account for the in-firm deliveries they make.

### Questions/Further Information

Questions about this *Notice* may be directed to John Linnehan, Director, Continuing Education, NASD, at (240) 386-4684.

### Background

The Regulatory Element, a computer-based education program that helps ensure that registered persons are kept up-to-date on regulatory, compliance, and sales practice matters in the industry, is a component of the Securities Industry Continuing Education Program (Program) under NASD Rule 1120. Member firms currently pay \$65 each time one of their registered persons participates in the Regulatory Element. The Securities Industry/Regulatory Council on Continuing Education (Council)<sup>1</sup> was organized in 1995 to facilitate cooperative industry/regulatory coordination of the administration and future development of the Program in keeping with applicable industry regulations and changing industry needs. It is the Council's

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responsibility to maintain the Program on a revenue-neutral basis while maintaining adequate reserves. In its annual financial review, the Council determined that Program reserves would remain adequate over the next two years if the fee for a Regulatory Element session were reduced by \$5. As such, at its December 2003 meeting, the Council unanimously supported a recommendation to the SROs to reduce the Regulatory Element fee to \$60, effective January 1, 2004. This is the second reduction in fees since the Program began in 1995. The first was a reduction of \$10 in 1999.

## Endnote

1 The Council consists of 20 individuals, six of whom represent self-regulatory organizations (the American Stock Exchange LLC; the Chicago Board Options Exchange, Inc.; the Municipal Securities Rulemaking Board; NASD; the New York Stock Exchange, Inc.; and the Philadelphia Stock Exchange, Inc.) and 14 who represent the industry. Its roles include recommending and

helping develop specific content and questions for the Regulatory Element, defining minimum core curricula for the Firm Element component of the Program, and developing and updating information about the Program for industry-wide dissemination.

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### 2003 – 2004 Filing Due Dates

NASD would like to remind members of their obligation to file the appropriate FOCUS reports, Annual Audits, and Customer Complaints by their due dates. The following schedule outlines due dates for 2004. Questions regarding the information to be filed can be directed to the appropriate District Office. Business questions as to how to file the FOCUS report, resetting passwords, and technical questions concerning system requirements, file uploads, and submission problems for Web-Based FOCUS and Customer Complaints can all be directed to (800) 321-NASD. Business questions regarding the Short Interest Reporting deadlines should be directed to Yvonne Huber at (240) 386-5034 or Jocelyn Mello at (240) 386-5091.

### 2004 FOCUS Due Dates

<b>Annual Schedule I for 2003 Year End</b>	<b>Due Date</b>
2003 FOCUS Schedule I	January 27, 2004
<b>Annual Schedule I for 2004 Year End</b>	<b>Due Date</b>
2004 FOCUS Schedule I	January 26, 2005

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## 2004 Monthly and Fifth\* FOCUS II/IIA Filings

\* A Fifth FOCUS report is an additional report that is due from a member whose fiscal year end is a date other than the calendar quarter.

January 31, 2004	February 25, 2004
February 29, 2004	March 23, 2004
April 30, 2004	May 25, 2004
May 31, 2004	June 23, 2004
July 31, 2004	August 24, 2004
August 31, 2004	September 24, 2004
October 31, 2004	November 23, 2004
November 30, 2004	December 23, 2004

## 2004 Quarterly FOCUS Part II/IIA Filings

<b>Quarter Ending</b>	<b>Due Date</b>
December 31, 2003	January 27, 2004
March 31, 2004	April 26, 2004
June 30, 2004	July 26, 2004
September 30, 2004	October 25, 2004
December 31, 2004	January 26, 2005

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## 2004 Annual Audit Filings Due Dates

<b>Period End</b>	<b>Due Date</b>
December 31, 2003	February 29, 2004
January 31, 2004	March 31, 2004
February 29, 2004	April 29, 2004
March 31, 2004	June 1, 2004
April 30, 2004	June 29, 2004
May 31, 2004	July 30, 2004
June 30, 2004	August 30, 2004
July 31, 2004	September 29, 2004
August 31, 2004	November 1, 2004
September 30, 2004	November 29, 2004
October 31, 2004	December 30, 2004
November 30, 2004	January 31, 2005
December 31, 2004	March 1, 2005

## 2004 3070/Customer Complaints Due Dates

4th quarter 2003:	January 15, 2004
1st quarter 2004:	April 15, 2004
2nd quarter 2004:	July 15, 2004
3rd quarter 2004:	October 15, 2004
4th quarter 2004:	January 17, 2005

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## Market Regulation Department 2004 Short Interest Reporting Deadlines

<b>Trade Date</b>	<b>Settlement Date</b>	<b>Exchange-Listed Short Interest Due*</b>	<b>NASDAQ Short Interest Due*</b>
January 12 Monday	January 15 Thursday	January 20 1:00 p.m., Tuesday	January 20 6:00 p.m., Tuesday
February 10 Tuesday	February 13 Friday	February 18 1:00 p.m., Wednesday	February 18 6:00 p.m., Wednesday
March 10 Wednesday	March 15 Monday	March 17 1:00 p.m., Wednesday	March 17 6:00 p.m., Wednesday
April 12 Monday	April 15 Thursday	April 19 1:00 p.m., Monday	April 19 6:00 p.m., Monday
May 11 Tuesday	May 14 Friday	May 18 1:00 p.m., Tuesday	May 18 6:00 p.m., Tuesday
June 10 Thursday	June 15 Tuesday	June 17 1:00 p.m., Thursday	June 17 6:00 p.m., Thursday
July 12 Monday	July 15 Thursday	July 19 1:00 p.m., Monday	July 19 6:00 p.m., Monday
August 10 Tuesday	August 13 Friday	August 17 1:00 p.m., Tuesday	August 17 6:00 p.m., Tuesday
September 10 Friday	September 15 Wednesday	September 17 1:00 p.m., Friday	September 17 6:00 p.m., Friday
October 12 Tuesday	October 15 Friday	October 19 1:00 p.m., Tuesday	October 19 6:00 p.m., Tuesday
November 9 Tuesday	November 15 Monday	November 17 1:00 p.m., Wednesday	November 17 6:00 p.m., Wednesday
December 10 Friday	December 15 Wednesday	December 17 1:00 p.m., Friday	December 17 6:00 p.m., Friday

\* Eastern Standard Time

# Disciplinary and Other NASD Actions

## REPORTED FOR DECEMBER

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 November 2003.

### Firm Expelled, Individual Sanctioned

U.S. Rica Financial, Inc. (CRD #38742, San Jose, California) and Vinh Huu Nguyen (CRD #2374393, Registered Principal, San Jose, California). The firm was expelled from NASD membership and fined \$120,000, jointly and severally with Nguyen. Nguyen was barred from association with any NASD member in any capacity. The National Adjudicatory Council (NAC) imposed the sanctions following appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that the firm, acting through Nguyen, made fraudulent representations to customers on the firm's Web site and on trade confirmations, stating that the firm executed agency trades and charged commissions in accordance with a published commission schedule or for "free" when, in fact, the respondent effected customer trades on a riskless principal basis through the firm's proprietary account and charged customers undisclosed markups and markdowns and thereby earned "secret profits." In addition, the firm, acting through Nguyen, failed to maintain memoranda of brokerage orders reflecting time of entry and time of execution of purchases of securities from other broker/dealers into the firm's inventory account and sales of securities to other broker/dealers from the firm's inventory account. (NASD Case #C01000003)

### Firm Fined, Individuals Sanctioned

Newbridge Securities Corporation (CRD #104065, Ft. Lauderdale, Florida), Scott Howard Goldstein (CRD #1630008, Registered Principal, Delray Beach, Florida), and James Lee Phelps (CRD #1725995, Registered Principal, Coconut Creek, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$60,000, and required to hire an outside consultant to review and make recommendations concerning the adequacy of the firm's current policies and procedures as they relate to its sales practices and supervisory system. Goldstein was fined \$10,000 and suspended from association with any NASD member in any capacity for 30 days. Phelps was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Goldstein and Phelps, failed to supervise its registered representatives adequately and failed to detect

apparent trading irregularities and inconsistent trading recommendations to customers by the firm's registered representatives. The findings also stated that, upon receipt of customer complaints against representatives of the firm, the firm, acting through Goldstein and Phelps, failed to establish, maintain, and enforce a reasonable supervisory system with a view towards preventing high-pressure sales tactics, unauthorized trading, misrepresentations or omissions, and unwarranted price projections. In addition, NASD found that the firm failed to record the entry and execution times on order tickets.

Phelps' suspension began November 17, 2003, and will conclude at the close of business December 16, 2003. Goldstein's suspension will begin December 17, 2003, and will conclude at the close of business January 15, 2004. (NASD Case #C07030069)

## Firms and Individuals Fined

**Baldwin & Clarke Capital Markets, Inc. (CRD #34380, Bedford, New Hampshire) and John Joseph Clarke, Jr. (CRD #1048942, Registered Principal, Epping, New Hampshire)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$15,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, as the placement agent for a private offering, failed to establish a proper escrow account at a bank. The findings also stated that, in connection with the private offering, the firm, acting through Clarke, authorized the partial release of \$280,000 from the escrow account to issuers at a time when the minimum contingency of \$650,000 had not been reached. The findings also stated that, because the offering's expiration date had passed, the escrowed funds should have been returned to investors. In addition, NASD found that the firm, acting through Clarke, permitted an individual to continue to perform duties as a registered person at a time his registration status with NASD was inactive due to his failure to complete the Regulatory Element of NASD's Continuing Education Rule 1120. Furthermore, NASD found that the firm, acting through Clarke, failed to have a written needs analysis and a written training plan in order to achieve compliance with the Firm Element of the Continuing Education Rule. (NASD Case #C11030037)

**Maximum Financial Investment Group, Inc. (CRD #40096, Troy, Michigan) and Christopher Thomes Paganes (CRD #2173707, Registered Principal, Birmingham, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$16,000, \$13,000 of which is jointly and severally with Paganes. Without admitting or denying the allegations, the firm and Paganes consented to the described sanctions and to the entry of findings that the firm, acting through Paganes, used the mails or other means or

instrumentalities of interstate commerce to effect transactions in securities when it failed to maintain the minimum required net capital. The findings also stated that the firm, acting through Paganes, prepared inaccurate trial balance and net capital computations. NASD also found that the firm, acting through Paganes, filed FOCUS Part IIA Reports with NASD that were inaccurate and overstated the firm's net capital. (NASD Case #C8A030082)

**Pennaluna and Co., Inc. (CRD #11604, Coeur d'Alene, Idaho) and Ronald Nicklas, Jr. (CRD #1055099, Registered Principal, Hayden Lake, Idaho)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured, fined \$10,000 jointly and severally, and ordered to pay \$7,877.20 in restitution to public customers. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Nicklas, effected sales of securities to public customers as principal and charged its customers more than a fair markup, taking into consideration all relevant circumstances, including market conditions with respect to such securities at the time of the transactions, the expense involved, and the fact that the firm was entitled to a profit. NASD found that the relevant markups ranged from approximately 8.1 to 150 percent. (NASD Case #C3B030018)

## Firms Fined

**A.B. Watley, Inc. (CRD #797, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures with respect to applicable securities laws and regulations concerning short-sale transactions within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it effected short-sale transactions in NASDAQ National Market (NNM<sup>®</sup>) securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning short-sale transactions. (NASD Case #CMS030233)

**Credit Suisse First Boston Corporation (CRD #816, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$38,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report through the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) last-sale reports of transactions in a NASDAQ SmallCap<sup>SM</sup> security. NASD found that the firm executed short-sale orders and failed to make an affirmative determination prior to executing such orders. The

findings stated that the firm, in customer transactions in which it acted as principal for its own account, failed to provide written notification disclosing to its customers the correct reported trade price, and provided incorrect written notification disclosing to its customers that the transaction was executed at an average price when it was not. The findings also stated that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in Consolidated Quotations Service (CQS) securities. In addition, NASD found that the firm transmitted to the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>) reports that contained inaccurate timestamps and account codes. The firm also transmitted to OATS execution reports that contained inaccurate, incomplete, or improperly formatted data that prevented the OATS system from linking the OATS execution reports to the related trade reports in the ACT Service. Furthermore, NASD found that the firm failed to timely report to OATS Reportable Order Events (ROEs). NASD also found that the firm submitted to OATS reports with respect to equity securities traded on The Nasdaq Stock Market that were not in the electronic form prescribed by NASD. The subject reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web Site. **(NASD Case #CMS030255)**

**Goldman, Sachs & Co. (CRD #361, 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 effected transactions in OTC Equity Options for public customer accounts that exceeded the applicable NASD Equity Option Position Limit. **(NASD Case #CMS030239)**

**INTL Trading Inc. (CRD #45993, Altamonte Springs, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$35,000. 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 OTC Equity securities, and failed to designate through ACT such last-sale reports as late. The findings also stated that firm incorrectly designated as “.SLD” through ACT last-sale reports of transactions in OTC Equity securities executed outside normal market hours. In addition, the findings stated that the firm failed to enforce supervisory procedures reasonably designed to achieve compliance with NASD’s rules regarding trade reporting. **(NASD Case #CMS030235)**

**Knight Equity Markets, L.P. (CRD #38599, Jersey City, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$43,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it was a party to a locked/crossed market condition prior to the market opening and received a

Trade-or-Move message in each instance through SelectNet<sup>®</sup> and, within 30 seconds of receiving such message, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market.

The findings also stated that the firm, as a market maker in securities, caused a locked/crossed market condition prior to the market opening by entering bid or ask quotations that locked/crossed another market maker’s quotations without immediately thereafter sending through SelectNet to the market maker(s) whose quotes it locked or crossed a Trade-or-Move message that was at the receiving market’s quoted price and whose aggregate size was at least 5,000 shares.

NASD also found that an order was presented to the firm at its published bid or offer in an amount up to its published quotation size and failed to execute the orders upon presentment, thereby failing to honor its published quotation. In addition, NASD found that the firm failed to report the correct execution time through ACT in one “as of” trade report of a transaction in an NNM security; incorrectly designated as “.PRP” through ACT last-sales reports of transactions in SmallCap securities and an OTC Equity security; failed to report the correct prior preference time through ACT in one report of a transaction in a SmallCap security for which the execution price was based on a prior reference point in time; executed long-sale transactions and incorrectly reported each to ACT with a short-sale or short-sale exempt modifier; and failed to report to ACT the correct symbol indicating whether the firm executed transactions in eligible securities as principal or agency. **(NASD Case #CMS030226)**

**Merrill Lynch, Pierce, Fenner & Smith Incorporated (CRD #7691, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$12,500, and required to revise its written supervisory procedures with respect to securities laws and regulations concerning the reporting of options positions to NASD within 30 days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to file with NASD a report with respect to each account which had established an aggregate position of 200 or more conventional option contracts (whether long or short) of the put class and call class on the same side of the market covering the same underlying security or index. The findings also stated that, in connection with the facilitation of an OTC collar transaction for a public customer, the firm established a short-stock position in an equity security and thereafter failed to maintain the size of its short-stock position in the security. In addition, NASD found that the firm’s supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning the reporting of options positions to NASD. **(NASD Case #CMS030251)**

**Metropolitan Investment Securities, Inc. (CRD #14146, Spokane, Washington)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured; fined \$500,000; ordered to offer \$2,882,010 in restitution to public customers; required to complete its review and revision, as appropriate, of all systems, supervision, training, and written procedures relating to the sales of all proprietary products to ensure that all material facts are disclosed to customers, that all recommendations to customers are suitable, and that all advertising and sales literature are in compliance with NASD rules; and ordered to establish a Special Escrow Account. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm, acting through its agents, engaged in fraudulent and deceptive sales practices by making material misrepresentations and omitting material facts in connection with the sale of proprietary products to customers.

The findings also stated that the firm, acting through its agents, did not have an adequate basis for recommending the proprietary products to certain investors, made recommendations and sales of proprietary products to public customers for whom such sales were unsuitable, and used misleading advertising and sales literature to sell the proprietary products. NASD found that these advertisements did not include adequate language regarding the risks associated with the proprietary products and omitted the principal risk factors associated with the investments. In addition, the findings stated that the advertisements also failed to provide a sound basis for evaluating the facts in regard to the proprietary product being offered. Furthermore, NASD found that the comparison of the proprietary products to bank products was unfair and unbalanced in that it failed to include the material differences between the subjects of comparison as required by NASD Rule 2210(D)(2). Moreover, NASD found that the firm, acting through its agents, disseminated sales scripts to its registered representatives that were, among other things, materially misleading in that they emphasized only the positive features of the proprietary products and omitted the principal risk factors; also, the scripts failed to provide a sound basis for evaluating the facts in regard to the proprietary products being offered. The findings also stated that the firm, acting through its agents, utilized form letters that were, among other things, materially misleading in that they emphasized only the positive features of the proprietary products, omitted the principal risk factors, and failed to provide a sound basis for evaluating the facts in regard to the proprietary products being offered.

NASD found that the firm's supervisory system and procedures were inadequate and did not appropriately deter and detect violations of NASD rules, including misrepresentation and omissions in the sale of its proprietary products, unsuitable recommendations and inadequate review and approval of sales of proprietary products, and misleading and violative advertising and sales literature. The findings also stated that the firm's written supervisory procedures were inadequate in that, among

other things, they did not specify how the registered representatives' activities would be monitored to ensure that they made fair and balanced sales presentations and suitable recommendations; the written supervisory procedures were completely silent regarding sales presentations regarding proprietary products; and, although many or most representatives sold primarily proprietary products to their customers, the firm did not provide adequate compliance training regarding sales presentations, and did not provide guidance concerning the risk level of the proprietary products or whether they were appropriate for investors with a low to medium risk tolerance and/or preservation of capital as a primary investment objective. NASD also found that the firm, acting through its agents, did not have reasonable grounds to believe the recommendations to customers of its proprietary products were reasonable, and failed to maintain in its files records indicating the basis for such recommendation. **(NASD Case #C3B030019)**

**Paragon Capital Markets, Inc. (CRD #18555, East Hanover, New Jersey)** 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 with respect to order execution quality reports, order routing information reports, and best execution within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report to ACT the contra side-executing broker in transactions in eligible securities. NASD found that, on trade dates, the firm failed to report to ACT the correct symbol indicating whether it executed transactions in eligible securities in a principal or agency capacity. The findings stated that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in OTC equity securities. In addition, NASD found that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in OTC equity securities and failed to designate through ACT such last-sale reports as late. Furthermore, NASD found that the firm incorrectly designated as ".T" through ACT last-sale reports of transactions in OTC equity securities executed during normal market hours; incorrectly designated as ".SLD" through ACT last-sale reports of transactions in OTC equity securities reported to ACT within 90 seconds of execution; failed to make available a report on the covered orders in national market system securities that it received for execution from any person; and failed to make available in a timely manner a report on the covered orders in a national market system securities that it received for execution from any person. Furthermore, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning order execution quality reports, order routing information reports, and best execution. **(NASD Case #CMS030250)**

**Pond Equities (CRD #30934, Brooklyn, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. 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 OTC Equity securities, and failed to designate through ACT such last-sale reports as late. (NASD Case #CMS030234)

**Pulse Trading, Inc. (CRD #104022, Boston, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$15,000, and required to revise its written supervisory procedures with respect to applicable securities laws and regulations concerning the Bid Test Rule within 30 days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it effected short-sale transactions in NNM securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. The findings also stated that firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning the Bid Test Rule. (NASD Case #CMS030236)

**Rushmore Securities Corporation (CRD #8392, Dallas, Texas)** 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 timely report to OATS ROEs during the review period. NASD found that the firm also submitted to OATS reports with respect to equity securities traded on The Nasdaq Stock Market that were not in the electronic form prescribed by NASD. The findings stated that the subject reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web Site. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning OATS reporting. (NASD Case #CMS030252)

**S & L, L.L.C. (CRD #47524, Northbrook, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$11,000, and required to revise its written supervisory procedures with respect to applicable securities laws and regulations concerning OATS within 30 days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to submit required information to OATS on 132 business days. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning OATS. (NASD Case #CMS030247)

**Signator Investors, Inc. (CRD #468, Boston, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$35,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that a registered representative of the firm misused and converted \$260,000 of municipal employee funds by placing them into non-participant accounts and into his own account. The findings also stated that the firm had inadequate written supervisory procedures relating to the supervision of accounts funded through employer payroll withholding. In addition, the findings stated that the firm's supervisory system was not reasonably designed to prevent and detect diversion of funds by registered representatives responsible for the firm's employer salary withholding accounts. NASD also found that the firm's supervisory system had inadequate checks and balances to confirm whether particular participants were entitled to certain allocations and whether individuals receiving funds were actually legitimate employee participants. (NASD Case #C11030038)

**The Seidler Companies Incorporated (CRD #3911, Los Angeles, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$19,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short-sale transactions in NNM securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. NASD also found that the firm executed short-sale orders and failed to maintain a written record of the affirmative determination made for such orders. The findings stated that the firm failed to report to ACT the correct symbol indicating whether transactions were buy, sell, sell short, sell short exempt, or cross transactions in eligible securities. The findings also stated that the firm failed to report to ACT the correct symbol indicating whether the firm executed transactions in eligible securities in a principal or agent capacity. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning the reporting of short-sale transactions to NASD. (NASD Case #CMS030227)

**Wilson-Davis & Co., Inc. (CRD #3777, Salt Lake City, Utah)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures with respect to the applicable securities laws and regulations concerning SEC Rules 11Ac1-5, 11Ac1-6, Best Execution, Transaction Reporting, OATS, and Anti-Competitive Practice within 30 days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to make available a report on the covered orders in national market system securities that it received for execution from any person. The findings also stated that the firm's supervisory system did

not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning SEC Rules 11Ac1-5, 11Ac1-6, Best Execution, Transaction Reporting, OATS, and Anti-Competitive Practice. (NASD Case #CMS030228)

**XCU Capital Corporation, Inc. (CRD #19899, Carlsbad, California)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$87,000, and required to offer to convert the B shares of public customers to A shares at its expense using a letter that includes a comparison of the cost of purchasing B shares with the cost of purchasing A shares over at least seven years and that includes the effect of internal expenses. The firm shall also require in-person attendance of all of its registered representatives and principals at a training program that addresses the economic considerations applicable to the recommendations of B shares and the availability of sales charge breakpoints. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm, acting through its agents, recommended and effected, or caused to be effected, purchases of large positions of Class B mutual fund shares in customer accounts without a reasonable basis for believing them to be suitable for the customers. The findings stated that the firm, acting through its agents, failed to establish, maintain, and enforce a supervisory system reasonably designed to enable the firm and its supervisors to prevent and detect unsuitable large Class B share positions. The findings further stated that the firm, acting through a registered representative, utilized sales materials that consisted of a hypothetical sales charge projection that was unbalanced and failed to provide prospective investors with a sound basis for evaluating the facts. NASD also found that the firm failed to file the projection with NASD's Advertising Regulation Department. (NASD Case #C02030067)

## Individuals Barred Or Suspended

**Mitchell Mark Almy (CRD #1059866, Registered Principal, Portland, Oregon)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for one month. Without admitting or denying the allegations, Almy consented to the described sanctions and to the entry of findings that he knowingly and intentionally entered priced limit orders in NASDAQ securities through a member firm account at its clearing firm in order to improve the National Best Bid or Offer (NBBO) through an electronic communications network (ECN). NASD found that, after having entered such orders, Almy knowingly and intentionally entered large orders on the other side of the market to buy and sell shares of such securities in a member firm proprietary account through a clearing firm. The findings stated that Almy knew that the orders placed on behalf of the member firm proprietary account would be routed to market makers whose automated execution systems were programmed to buy or

sell, and did buy or sell, such securities on an automated basis at prices equal to the NBBO and in an amount greater than the NBBO. The findings also stated that Almy, by knowingly and intentionally engaging in this course of conduct, was able, on behalf of a member proprietary account, to buy shares of these securities at prices that were lower, and sell shares at prices that were higher, than he would otherwise have been able to obtain, but for his entry of the NBBO improving orders into securities. In addition, NASD found that, within a short time after Almy received the executions of the orders, he knowingly and intentionally canceled each of the priced limit orders that he had placed, thereby generating profits of approximately \$685.

Almy's suspension began December 1, 2003, and will conclude at the close of business December 31, 2003. (NASD Case #CMS030253)

**Theodore Sanidad Alvia (CRD #3086395, Registered Representative, Schaumburg, Illinois)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Alvia executed securities transactions in the accounts of public customers without the knowledge or consent of the customers and in the absence of written or oral authorization to exercise discretion in the accounts. The findings also stated that Alvia failed to respond to NASD requests for information. (NASD Case #C8A030028)

**Leslie Anne Andrade (CRD #1225136, Associated Person, Greeley, Colorado)** 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, Andrade consented to the described sanction and to the entry of findings that she made false journal entries to the ledgers of her member firm to conceal trading losses incurred by another individual. NASD found that upon instructions from the individual, Andrade made journal entries to the ledgers of the firm to facilitate and conceal the conversion of public customers, fully-paid for money market securities to cover the individual's trading losses. The findings also stated that Andrade knowingly provided substantial assistance to the individual in connection with their conversion of customer securities, and Andrade knew that her conduct was illegal or improper. (NASD Case #C3A030045)

**Keith Jacob Andrews (CRD #2089621, Registered Representative, Romeoville, Illinois)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Andrews consented to the described sanction and to the entry of findings that he endorsed a \$10,000 check made payable to a public customer and deposited the check into an account he controlled, without the customer's authorization, knowledge, or consent. The findings also stated that Andrews failed to respond to NASD requests for information and documentation. (NASD Case #C8A030070)

**Anthony James Apuzzo (CRD #2431669, Registered Representative, Staten Island, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Apuzzo, while using the means and instrumentalities of interstate commerce to offer securities for sale, omitted to state material facts necessary in order to make the statements made in connection with such offer, in light of the circumstances in which they were made, not misleading. The findings also stated that Apuzzo made material misrepresentations in the form of price predictions to induce transactions, and the transactions did occur. (NASD Case #C3A030007)

**John Robert Bingham (CRD #1917145, Registered Representative, Keller, Texas)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Bingham effected \$2,007,833.61 in unauthorized transactions in the account of public customers for his own economic benefit without the customers' prior knowledge or consent. The findings also stated that Bingham failed to respond to NASD requests for information. (NASD Case #C05020060)

**Richard Graham William Boardman (CRD #834736, Registered Principal, Cambridge, Massachusetts)** 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, Boardman consented to the described sanction and to the entry of findings that he converted approximately \$137,000 of a public customer's funds intended for investment purposes, without the knowledge, authorization, or consent of the customer. (NASD Case #C11030036)

**Robert Preston Buckingham (CRD #2808859, Registered Representative, Omaha, Nebraska)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Buckingham processed checks received by his member firm from public customers totaling \$95,000 for the purchase of securities without the customers' knowledge or consent and deposited the checks into his personal account at the firm, thereby converting the funds to his own use and benefit. The findings also stated that Buckingham failed to respond to NASD requests for information. (NASD Case #C04030006)

**Thomas Steven Canecchia (CRD #2138352, 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 capacity for six months. The fine must be paid before Canecchia reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Canecchia consented to the described sanctions and to the entry

of findings that he allowed individuals to engage in a securities business, for compensation, while not properly registered with NASD.

Canecchia's suspension began December 1, 2003, and will conclude at the close of business May 31, 2004. (NASD Case #C10030094)

**Hyek Chung (CRD #3195676, Registered Representative, Toledo, Ohio)** 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 two years. The fine must be paid before Chung reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Chung consented to the described sanctions and to the entry of findings that he received \$11,000 from a public customer to be used to transact short sales in a common stock in Chung's personal securities account. The findings also stated that Chung deposited the funds into his personal checking account and, sold shares of the stock for his personal securities account, but failed to keep an accounting of which short sales were for the benefit of the customer and which were for his own benefit. In addition, the findings stated that the customer directed Chung to cover the short sales but there were no funds available in the account to make the purchases to cover the short sales, thereby using the funds of the customer for some purpose other than the benefit of the customer without the customer's knowledge and authorization.

Chung's suspension began November 17, 2003, and will conclude at the close of business November 16, 2005. (NASD Case #C8B030021)

**Alan Steven Cohen (CRD #2237526, Registered Principal, Brooklyn, 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 60 days. In light of the financial status of Cohen, no monetary sanction has been imposed. Without admitting or denying the allegations, Cohen consented to the described sanction and to the entry of findings that he represented to a public customer that he and at least one other broker would act as representatives on the customer's joint account but failed to trade the joint account and to monitor the activities in the account. The findings also stated that Cohen failed to advise adequately public customers that their account would be traded pursuant to a day-trading strategy and the risks associated with day trading. In addition, NASD found that, without sufficient knowledge of the activities in the joint account, Cohen failed to disclose to the customer that he was not monitoring activities in the account, improperly told a public customer that he need not be concerned about activities in the account, and gave assurances concerning the account when he did not know all the material facts.

Cohen's suspension began November 17, 2003, and will conclude at the close of business January 15, 2004. (NASD Case #C10030083)

**Michael Paul DeMarse (CRD #2166872, Registered Principal, Paramus, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was ordered to pay \$64,949, plus interest, in restitution to a public customer and barred from association with any NASD member in any capacity. The restitution must be paid before DeMarse reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, DeMarse consented to the described sanctions and to the entry of findings that he made improper use of \$18,000 from a public customer's account. NASD also found that DeMarse exercised control over a public customer's accounts and effected numerous and excessive securities transactions in the accounts in a manner that was inconsistent with the customer's financial situation, investment objectives, and needs. The findings also stated that DeMarse failed to respond to NASD requests for information. (NASD Case #C9B030078)

**Frank DePasquale (CRD #2966311, Registered Principal, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$30,000, including disgorgement of \$25,000, and suspended from association with any NASD member in any capacity for seven months. The fine must be paid before DePasquale reassociates with a member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, DePasquale consented to the described sanctions and to the entry of finding that he entered into an arrangement with another individual who was not properly registered in the State of New Jersey to sell securities to circumvent New Jersey's denial of registration. NASD found that, as part of this arrangement, the individual falsified a New Jersey public customer's account records so that DePasquale appeared as the registered representative of record for an account actually handled by the individual. The findings also stated that DePasquale and the individual equally split all commissions paid as a result of transactions in that account even though the individual solely controlled the subject account and was not registered to sell securities in New Jersey. In addition, NASD found that DePasquale improperly received approximately \$25,000 in commissions from the trading activity in the account.

DePasquale's suspension began October 16, 2003, and will conclude May 15, 2004. (NASD Case #C9B030073)

**Patrick W. Donohue (CRD #4168054, Registered Representative, Moreno Valley, California)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Donohue forged a public customer's signature to effect wire transfers and transferred \$6,000 from the customer's account at his member firm to his personal bank account, thereby converting the funds to his own use and benefit.

The findings also stated that Donohue failed to respond to NASD requests for information. (NASD Case #C02030030)

**Stephen Jay Drescher (CRD #2619465, Registered Principal, Remsenburg, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Drescher engaged in securities fraud and in a conspiracy to commit securities fraud. (NASD Case #CAF020029)

**Michael Frederick Flannigan (CRD #1135700, Registered Principal, Excelsior, Minnesota)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for five business days and barred from association with any NASD member in any principal or supervisory capacity. In light of the financial status of Flannigan, no monetary sanctions have been imposed. Without admitting or denying the allegations, Flannigan consented to the described sanctions and to the entry of findings that, acting on behalf of his member firm, he employed an individual as a general securities representative in the branch office of his member firms; and allowed, aided, and assisted the individual in assuming the duties and performing the functions of a registered principal, including general supervision of the branch, without being properly registered. The findings also stated that Flannigan failed to establish and maintain a system to supervise the activities of registered representatives and associated persons designed to achieve compliance with applicable laws, rules, and regulations related to obtaining customer account information for customers at the branch office. The findings also stated that Flannigan failed to obtain suitability information regarding public customers and to transcribe it on new account forms relating to the firm's participation in an offering and the customers' purchase of shares in the offering. In addition, the findings stated that Flannigan participated in a penny stock offering and failed to comply with the requirements of SEC rules 15g-1 through 15g-9.

Flannigan's suspension began December 1, 2003, and concluded at the close of business December 5, 2003. (NASD Case #C04030024)

**Lee Edward Goldner (CRD #1613576, Registered Representative, South Haven, Michigan)** submitted an Offer of Settlement in which he was fined \$12,293, including disgorgement of commissions received of \$9,793, and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Goldner consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, and failed and neglected to give prompt written notice to his member firm.

Goldner's suspension began November 24, 2003, and will conclude at the close of business December 23, 2003. (NASD Case #C8A030018)

**Delbert William Gray (CRD #1374128, Registered Representative, Meridian, Idaho)** 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, Gray consented to the described sanction and to the entry of findings that, without the knowledge or consent of public customers, he deposited \$817,122 of the customers' funds that were intended for the purchase of securities into a bank account he controlled, thereby converting the customers' funds to his own use and benefit. The findings stated that Gray subsequently returned \$37,000 to the customers, thereby converting \$780,122 of customers' funds to his own use and benefit. (NASD Case #C3B030017)

**Drummond Bernard Grearson MacKinnon (CRD #1505953, Registered Representative, Belton, Missouri)** 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 MacKinnon reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, MacKinnon consented to the described sanctions and to the entry of findings that he executed unauthorized transactions in the accounts of public customers without their prior knowledge, authorization, or consent.

MacKinnon's suspension began November 17, 2003, and will conclude May 16, 2004. (NASD Case #C04030056)

**Robert Douglas Grimes (CRD #1223554, Registered Representative, Covington, Louisiana)** 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, Grimes consented to the described sanction and to the entry of findings that he requested his member firm to wire funds or issue checks totaling \$326,402 for the purpose of withdrawing funds from the securities and individual retirement accounts of a public customer and converted the funds to his own use and benefit by endorsing and negotiating the checks without the knowledge or consent of the customer. The findings also stated that Grimes failed to respond to NASD requests for information. (NASD Case #C05030053)

**Rudi Richard Hoffman (CRD #1172103, Registered Principal, Port Orange, Florida)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the allegations, Hoffman consented to the described sanctions and to the entry of findings that he failed to timely amend his Uniform Application for Securities Registration or Transfer (Form U4).

Hoffman's suspension began December 1, 2003, and will conclude at the close of business January 29, 2004. (NASD Case #C07030014)

**William Gordon Hoover, Jr. (CRD #249808, Registered Representative, Greenwood Village, Colorado)** 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, Hoover consented to the described sanction and to the entry of findings that, while associated with his member firm, he participated in private securities transactions without providing written notification to, or obtaining written approval from, the firm. The findings also found that Hoover failed to disclose material facts on his Form U4. NASD also stated that Hoover failed to respond to NASD requests for information. (NASD Case #C3A030043)

**Gary Joseph Hudecek (CRD #1757339, Registered Representative, Riverside, 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, Hudecek consented to the described sanction and to the entry of findings that, while associated with a member firm, he made improper use of a public customer's funds without authorization. (NASD Case #C8A030072)

**Robert William Jenkins, IV (CRD #2222958, Registered Representative, Mendon, 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, Jenkins consented to the described sanction and to the entry of findings that he engaged in private securities transactions, for compensation, without providing written notice to, or receiving approval from, his member firm prior to engaging in such activities. The findings also stated that Jenkins provided documents to NASD that he knew, or should have known, were false or had been forged. The findings further stated that Jenkins failed to respond to NASD requests for information. (NASD Case #C8A030076)

**Kirk William Kanatani (CRD #2101338, Registered Representative, Prairieville, Louisiana)** 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 business days. Without admitting or denying the allegations, Kanatani consented to the described sanctions and to the entry of findings that he recommended and effected the purchase of a variable life contract by a public customer without having reasonable grounds for believing that the recommendation and resultant transactions were suitable for the customer on the basis of his financial situation and needs.

Kanatani's suspension began December 15, 2003, and will conclude at the close of business January 27, 2004. (NASD Case #C05030057)

**John Joseph Katsock, Jr. (CRD #2497641, Registered Principal, New York, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Katsock omitted to disclose material information to public customers. NASD found that Katsock made an unsuitable recommendation to a public customer and made improper and baseless price predictions. The findings also stated that Katsock failed to respond to NASD requests to appear for on-the-record interviews. **(NASD Case #C9A020018)**

**Bradley Evan Kirk (CRD #4332339, Registered Representative, Crystal Lake, Illinois)** 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 nine months. The fine must be paid before Kirk reassociates with any NASD member following the suspension or before requesting for relief from any statutory disqualification. Without admitting or denying the allegations, Kirk consented to the described sanctions and to the entry of findings that he completed disability income policy applications and forged the signatures of public customers to be applied on the policies without the customers' knowledge or consent. The findings also stated that Kirk submitted the applications to insurance companies for processing and paid the initial 12-month premium for each policy out of his personal business checking account without the customers' knowledge or consent.

Kirk's suspension began December 1, 2003, and will conclude at the close of business August 31, 2004. **(NASD Case #C8A030074)**

**Nick Lalla (CRD #4545441, Registered Representative, Patchogue, New York)** submitted an Offer of Settlement in which he was fined \$3,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Lalla reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Lalla consented to the described sanctions and to the entry of findings that he failed to disclose material facts on his Form U4.

Lalla's suspension began November 17, 2003, and will conclude May 16, 2004. **(NASD Case #CLI030018)**

**Frank Anthony Leonardo (CRD #2523774, Registered Principal, Flushing, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Leonardo willfully failed to disclose material information on his Form U4. **(NASD Case #C9B030028)**

**Cynthia Lee Lunsford (CRD #4491853, Registered Representative, Columbus, Indiana)** submitted a Letter of Acceptance, Waiver, and Consent in which she was suspended from association with any NASD member in any capacity for 18

months. In light of the financial status of Lunsford, no monetary sanctions were imposed. Without admitting or denying the allegations, Lunsford consented to the described sanction and to the entry of findings that she affixed the signatures of public customers on confidential suitability questionnaires and master account agreements, and affixed the initials of public customers on insurance needs worksheets without the customers' knowledge or consent.

Lunsford's suspension began December 1, 2003, and will conclude at the close of business May 31, 2005. **(NASD Case #C8A030079)**

**David Nshoya Magoti (CRD #4536274, Associated Person, East Lansing, Michigan)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Magoti failed to respond to NASD requests for information. The findings also stated that Magoti willfully failed to disclose a material fact on his Form U4. **(NASD Case #C8A030041)**

**Paul Anthony Matten (CRD #1312239, Registered Representative, New York, 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, Matten consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for documents and information. **(NASD Case #CMS030231)**

**Enrico Mazzola (CRD #2162960, Registered Representative, East Northport, 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 15 business days. The fine must be paid before Mazzola reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Mazzola consented to the described sanctions and to the entry of findings that he engaged in activities that required registration with NASD while his registration status was inactive due to his failure to complete the Regulatory Element of NASD's Continuing Education Requirement.

Mazzola's suspension began December 1, 2003, and will conclude at the close of business December 19, 2003. **(NASD Case #C10030092)**

**James Lawrence McMahan (CRD #1609091, Registered Representative, Atlanta, Georgia)** 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 one year. The fine must be paid before McMahan reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without

admitting or denying the allegations, McMahan consented to the described sanctions and to the entry of findings that he received non-public confidential information and passed on the information to a client, recommending that the client purchase shares of stock and liquidate the stock the following day on the assumption the share price would rise. The findings stated that the customer purchased the stock and McMahan earned commissions on the trade and expected the benefit of an improved reputation with his customer.

McMahan's suspension began November 17, 2003, and will conclude at the close of business November 16, 2004. (NASD Case #C07030074)

**Gabriel Frank Migliano, Jr. (CRD #2687663, Registered Representative, Brooklyn, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, required to pay \$22,508 in disgorgement of commissions in partial restitution to a customer, and suspended from association with any NASD member in any capacity for one month. The fine must be paid before Migliano reassociates with an NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Migliano consented to the described sanctions and to the entry of findings that he exercised control over the account of a customer and effected numerous securities transactions in this account using unsuitable levels of margin in a manner that was inconsistent with the customer's investment objectives. Migliano's suspension began November 3, 2003, and concluded at the close of business December 2, 2003. (NASD Case #C9B030072)

**James Robert Miller (CRD #4269827, Registered Representative, Wauwatosa, Wisconsin)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Miller consented to the described sanction and to the entry of findings that he prepared and submitted to his member firm academic credit confirmations and indemnity and hold harmless agreements for students in an internship program that he knew, or should have known, bore the forged signatures of university representatives. (NASD Case #C8A030068)

**Robert Theodore Milley, II (CRD #1607431, Registered Representative, Yardley, Pennsylvania)** 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 60 days. The fine must be paid before Milley reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Milley 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 of the transaction and his proposed role therein.

Milley's suspension began November 17, 2003, and will conclude at the close of business January 15, 2004. (NASD Case #C9A030035)

**Jeffrey Jonathan Mills (CRD #2695464, Registered Representative, West Orange, New Jersey)** was fined \$5,000 and suspended from association with any NASD member in any capacity for 12 months. The sanction was based on findings that Mills willfully failed to disclose material information on his Form U4.

Mills' suspension began October 20, 2003, and will conclude at the close of business October 20, 2004. (NASD Case #C10020076)

**Larry Laverne Nelson (CRD #1378197, Registered Principal, Coral Springs, Florida)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for 10 business days and barred from association with any NASD member in any principal or supervisory capacity. In light of the financial status of Nelson, no monetary sanctions have been imposed. Without admitting or denying the allegations, Nelson consented to the described sanctions and to the entry of findings that he failed to establish and maintain a system to supervise the activities of registered representatives and associated persons that was reasonably designed to achieve compliance with applicable laws, rules, and regulations related to obtaining customer account information for customers at a branch office of his member firm. The findings also stated that Nelson failed to obtain vital suitability information regarding public customers, and failed to transcribe it on new account forms relating to the firm's participation in an offering and the customers' purchase of shares in the offering. In addition, the findings stated that Nelson, acting on behalf of his member firm, permitted, aided, and assisted an individual in performing the functions of a registered representative without being properly registered with NASD. The findings further stated that Nelson, acting on behalf of his member firm, participated in an offering and failed to comply with the requirements of SEC Rules 15g-1 through 15g-9.

Nelson's suspension began December 1, 2003, and concluded at the close of business December 12, 2003. (NASD Case #C04030024)

**William Thomas Newmiller (CRD #4606691, Associated Person, Drexel Hill, Pennsylvania)** 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 three months. The fine must be paid before Newmiller reassociates with any member following the suspension or prior to requesting relief from any statutory disqualification. Without admitting or denying the allegations, Newmiller consented to the described sanctions and to the entry of findings that he willfully failed to disclose a material fact on his Form U4.

Newmiller's suspension began December 1, 2003, and will conclude February 29, 2004. (NASD Case #C9A030036)

**Kenneth Onorato (CRD #4106235, Registered Representative, Copiague, 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, Onorato consented to the described sanction and to the entry of findings that he deposited \$1,000 into his personal checking account rather than the account of a public customer while processing wire transfers for the customer. (NASD Case #CLI030022)

**Anthony Frank Rana (CRD #4548061, Associated Person, Perth Amboy, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for nine months. The fine must be paid before Rana reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Rana consented to the described sanctions and to the entry of findings that he willfully failed to disclose a material fact on his Form U4. NASD also found that Rana failed to respond timely to NASD requests for information.

Rana's suspension began December 1, 2003, and will conclude at the close of business August 31, 2004. (NASD Case #C9B030075)

**Abraham Salzberg (CRD #2896451, Registered Principal, Brooklyn, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,500 and suspended from association with any NASD member in any capacity for 45 business days. The fine must be paid before Salzberg reassociates with any NASD member in any capacity following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Salzberg consented to the described sanctions and to the entry of findings that he engaged in an outside business activity without providing prompt written notice to his member firm.

Salzberg's suspension began November 17, 2003, and will conclude at the close of business January 21, 2004. (NASD Case #C10030084)

**Mike Shamai (CRD #4251905, Registered Representative, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 30 business days. Without admitting or denying the allegations, Shamai consented to the described sanctions and to the entry of findings that he settled a public customer's complaint alleging unauthorized trading by executing a settlement agreement with the customer in which he agreed to

reimburse the customer for various losses from securities transactions without informing and obtaining authorization from his member firm.

Shamai's suspension began December 1, 2003, and will conclude with the close of business January 13, 2004. (NASD Case #C10030089)

**Daniel Michael Spalango, Jr. (CRD #2538943, Registered Representative, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, including disgorgement of \$5,991.69 in commissions, required to pay \$38,067.53 in restitution to a public customer, and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Spalango reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Spalango consented to the described sanctions and to the entry of findings that he exercised control over the account of a public customer, effected numerous and excessive securities transactions in the account, and used unsuitable levels of margin in a manner that was inconsistent with the customer's investment objectives.

Spalango's suspension began December 1, 2003, and will conclude at the close of business May 31, 2004. (NASD Case #C9B030077)

**Mitzi Sue Stamps (CRD #1339173, Registered Principal, Lenior City, Tennessee)** 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, Stamps consented to the described sanction and to the entry of findings that she issued checks totaling \$24,099.51 made payable to herself from the operating account of her member firm and converted the funds to her own use and benefit by endorsing and negotiating the checks, without the knowledge or consent of her member firm. (NASD Case #C05030054)

**Todd Christopher Sunday (CRD #2682966, Registered Representative, Columbus, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, suspended from association with any NASD member in any capacity for eight weeks, and ordered to disgorge \$5,250, plus interest, in commissions in partial restitution to public customers. The fine and restitution must be paid before Sunday reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Sunday consented to the described sanctions and to the entry of findings that he engaged in a private securities transaction, for compensation, and failed and neglected to give written notice to, and receive written approval from, his member firm.

Sunday's suspension began December 15, 2003, and will conclude February 8, 2004. (NASD Case #C8B030024)

**Ryan Michael Sweeney (CRD #3068278, Registered Representative, Doylestown, 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, Sweeney consented to the described sanction and to the entry of findings that he converted \$5,700 from a business owned and operated by a fellow registered representative of his member firm. NASD found that Sweeney converted these funds by withdrawing the funds from the business and owner's bank accounts and using the funds for his own purposes. (NASD Case #C9A030037)

**Larry Andrew Tipton (CRD #447261, Registered Representative, Seminole, Florida)** 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 30 days. The fine must be paid before Tipton reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Tipton consented to the described sanctions and to the entry of findings that he signed promissory notes to a former public customer to reimburse the customer for losses relating to a stock purchase incurred in the customer's account at a member firm.

Tipton's suspension began December 1, 2003, and will conclude at the close of business December 30, 2003. (NASD Case #C07030076)

**William Clarence Thrower (CRD #4590916, Associated Person, Englewood, Colorado)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Thrower failed to respond to NASD requests for information. NASD also found that Thrower failed to disclose material information on his Form U4. (NASD Case #C3A030013)

**Steven Wayne Torrico (CRD #1666636, Registered Supervisor, Glen Rock, 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 principal or supervisory capacity for three months and required to requalify as a general securities sales supervisor. Without admitting or denying the allegations, Torrico consented to the described sanctions and to the entry of findings that he failed to reasonably supervise certain mutual fund sales by a registered representative as to detect and prevent violations of applicable NASD and SEC rules.

Torrco's suspension began December 1, 2003, and will conclude February 29, 2004. (NASD Case #C9B030074)

**Keith Kai Wong (CRD #3176078, Registered Representative, Bayside, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$6,000 and suspended from association with any NASD member in any capacity for 20 business days. The fine must be paid before Wong reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Wong consented to the described sanctions and to the entry of findings that, in an attempt to mollify a public customer complaint about contingent deferred sales charges incurred as a result of mutual fund sales, he paid \$2,207 to the customer's personal representative and Power of Attorney to settle the complaint without the knowledge or consent of his member firm.

Wong's suspension began November 17, 2003, and will conclude at the close of business December 15, 2003. (NASD Case #C10030085)

**Ilya Steven Zeidenfeld, Jr. (CRD #2623090, Registered Representative, West Long Branch, 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 60 days. The fine must be paid before Zeidenfeld reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Zeidenfeld consented to the described sanctions and to the entry of findings that he effected securities transactions away from his member firm without prior written notification to his member firm.

Zeidenfeld's suspension began November 17, 2003, and will conclude at the close of business January 15, 2004. (NASD Case #C10030086)

**James Charles Zerilli (CRD #1041268, Registered Representative, Grosse Point Woods, Michigan)** 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 two years. The fine must be paid before Zerilli reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Zerilli consented to the described sanctions and to the entry of findings that he affixed, or caused to be affixed, the signatures of public customers to life insurance perspective fixed and variable annuity applications, a request for transfer of assets, and a perspective variable annuity service request form and submitted them to an insurance company without the consent or knowledge of the customers.

Zerilli's suspension began December 1, 2003, and will conclude at the close of business November 30, 2005. (NASD Case #C8A030077)

## 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.

**John Douglas Audifferen (CRD #2053214, Registered Representative, Brooklyn, New York)** was named as a respondent in an NASD complaint alleging that he purchased shares of stock for a public customer in the cash account of the customer at his member firm and knew, or should have known, that the customer did not have sufficient cash to cover the cost of the purchases. The complaint also alleges that Audifferen deposited his own funds into the account to cover the cost of the purchases, thereby willfully violating Regulation T by directly or indirectly extending credit to or for the customer's account. In addition, the complaint alleges that Audifferen sold securities from the account of a public customer, received \$17,500 from the customer that represented, in part, proceeds from the sale, thereby obtaining the beneficial use of an extension of credit and willfully causing his member firm to violate Regulation T. Moreover, the complaint alleges that Audifferen maintained a securities account at his member firm, purchased and sold securities in the account, and knew he did not have sufficient margin or sufficient funds to cover the costs of the purchases, thereby causing his member firm to make an extension of credit to him in violation of Regulation T. Furthermore, the complaint alleges that Audifferen failed to disclose information on his Form U4. (NASD Case #C10030095)

**Elena Laura Bianchi (CRD #1675129, Registered Representative, Houston, Texas)** was named as a respondent in NASD complaint alleging that she effected securities transactions in the accounts of public customers through the use of discretion without obtaining written authorization from the customers to use discretion in their accounts and without obtaining acceptance in writing by her member firm of the accounts as discretionary. (NASD Case #C06030024)

**Perrin F. Burse (CRD #1908857, Registered Principal, Cincinnati, Ohio)** was named as a respondent in an NASD complaint alleging that he made unsuitable recommendations to a public customer to purchase Class B shares in mutual funds and fund families when the customer did not intend to hold the funds long-term and Burse failed to obtain sales load discounts, breakpoint discounts, and to use letters of intent in recommending the purchases of mutual funds. The complaint also alleges that Burse recommended to a public customer to liquidate mutual funds and use the proceeds to purchase other Class B share mutual funds having similar investment objectives and the

recommendations incurred additional sales charges to the customer. The complaint further alleges that Burse recommended and effected the purchase of a \$1,160,000 variable life insurance policy to a public customer without having reasonable grounds for believing the recommendation and resulting transaction were suitable for the customer on the basis of his financial situation, investment objectives, and needs.

In addition, the complaint alleges that Burse affixed the signature of public customers on a Client Agreement to open an account at his member firm, on documents acknowledging that contingent deferred sales charges may be incurred when investing in Class B share mutual funds, and on distribution request forms authorizing the withdrawal of monies from the customer's securities account. Moreover, the complaint alleges that Burse engaged in a private securities transaction and failed to provide prior written notice to, and receive written authorization or acknowledgement from, his member firm. Furthermore, the complaint alleges that Burse obtained, in bad faith, a \$25,000 loan from a public customer and he has made no payments on the loan. The complaint also alleges that Burse failed to respond to NASD requests for documents and information. (NASD Case #C8B030023)

**Gilbert Alan Cardillo (CRD #1110960, Registered Principal, Riverhead, New York)** was named as a respondent in an NASD complaint alleging that he made an unsuitable recommendation to a public customer without reasonable grounds for believing the transaction was suitable for the customer based on the customer's financial situation and needs. (NASD Case #C10030087)

**Howard Francis Curd (CRD #1786714, Registered Principal, Manhasset, New York)** was named as a respondent in an NASD complaint alleging that a member firm, acting through Curd, failed to obtain the signature or initials of a principal of the firm indicating approval of research reports it disseminated. The complaint also alleges that Curd failed to file research reports with NASD's Advertising Regulation Department and failed to file the actual or anticipated date of first use. In addition, the complaint alleges that Curd failed to establish, maintain, and enforce written supervisory procedures and systems to supervise the activities of registered representatives and associated persons reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules. Moreover, the complaint alleges that Curd knew, or should have known, of "red flags," in that one or more research reports failed to disclose material facts and contained material misrepresentations. Furthermore, the complaint alleges that Curd effected wash trades in securities between personal and corporate securities accounts that he owned or held an interest in to create the false appearance of trading volume and market interest in the securities.

The complaint also alleges that Curd, by the use of any means or instrumentality of interstate commerce or of the mails, knowingly or recklessly engaged in manipulative or deceptive

devices or contrivances in connection with the purchase or sale of securities; knowingly or recklessly engaged in manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities; and knowingly or recklessly 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 Curd filed SEC Forms 3 and 5 and failed to report shares of a security in which he was a beneficial owner and failed to file an SEC Form 4 disclosing the selling and purchasing shares of the security. In addition, the complaint alleges that Curd was responsible for ensuring his firm's books and records were properly prepared and maintained and failed to maintain order tickets, corporate resolutions for accounts, new account forms, and e-mails that he received in his firm e-mail account. (NASD Case #CAF030056)

**David Logan Froede (CRD #2032725, Registered Representative, Grand Rapids, Michigan)** was named as a respondent in an NASD complaint alleging that, while associated with a member firm, he sent an account statement to a public customer that purported to reflect all activity in the customer's account for the previous twelve months but was misleading because it failed to reflect several transactions. The complaint also alleges that Froede signed, or caused to be signed, the customer's name on checks and withdrew \$250,000 from the customer's account and converted it to his own use and benefit without the customer's authorization, knowledge, or consent. The complaint further alleges that Froede failed to respond to NASD requests for information and documentation. (NASD Case #C8A030075)

**Jerri Sharon Hunter (CRD # 4405016, Registered Representative, Silver Spring, Maryland)** was named as a respondent in an NASD complaint alleging that she received \$2,578 from a public customer to assist the customer in selling a real estate time share, failed to assist the customer with selling the time share, and did not return the funds to the customer, thereby converting the funds. The complaint also alleges that Hunter failed to respond to NASD requests for information. (NASD Case #C07030070)

**L.H. Ross & Company, Inc. (CRD #37920, Boca Raton, Florida), Sierra Brokerage Services, Inc. (CRD #36573, Columbus, Ohio), and Franklyn Ross Michelin (CRD #2459180, Registered Principal, Boca Raton, Florida)** were named as respondents in an NASD complaint alleging that they participated, directly or indirectly, in undertakings involving the purchase of securities from issuers or affiliates of issuers with a view to the distribution of a common stock, and thereby acted as underwriters of unregistered securities. The complaint also alleges that L.H. Ross, acting through Michelin, directly or indirectly, bid for, purchased, or attempted to induce persons to bid for or purchase a security that was the subject of a

distribution while the firm was acting as a distribution participant. In addition, the complaint alleges that L.H. Ross and Sierra Brokerage engaged in a series of wash sales that created the false appearance of trading volume and market interest in a common stock and operated as a manipulation of the market in the stock. Moreover, the complaint alleges that L.H. Ross, Michelin, and Sierra Brokerage, by the use of any means or instrumentality of interstate commerce or of the mails, knowingly or recklessly engaged in manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities, and knowingly or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive, or other fraudulent devices or contrivances. Furthermore, the complaint alleges that L.H. Ross and Sierra Brokerage, acting through Michelin and others, engaged in a series of sales to public customers involving misrepresentations and omissions, unauthorized trades, and failures to execute sale orders.

The complaint alleges that L.H. Ross, acting through Michelin, effected transactions as principal at prices that were not fair and reasonable and taking into consideration all of the relevant factors. The complaint also alleges that L.H. Ross, acting through Michelin, charged its retail customers markups greater than 10 percent from the prevailing market price in transactions. In addition, the complaint alleges that L.H. Ross effected purchases of a common stock in customer accounts without the knowledge or authorization of the customers. The complaint also alleges that L.H. Ross failed to execute customer sell orders and made material misrepresentations and/or omitted material facts, including baseless price predictions in connection with the offer and sale of a common stock. Furthermore, L.H. Ross and Michelin failed to take reasonable and appropriate steps to ensure that the firm and its agents did not violate federal securities laws or NASD rules concerning fraudulent, abusive, and illegal sales practices. Moreover, L.H. Ross and Michelin failed to devise, maintain, and enforce a supervisory system that provided any mechanism or system to identify unregistered or restricted securities, ensuring that markups charged to customers were fair and ensuring that the firm did not engage in prohibited conduct during a distribution. (NASD Case #CAF030055)

**Paul Edward Mize (CRD #2206359, Registered Representative, Sedona, Arizona)** was named as a respondent in an NASD complaint alleging that he received \$50,000 from the sale of insurance policies of a public customer to a viaticals company, deposited the check in his personal bank account, and gave the customer \$9,500 to pay medical bills, but he has not remitted the remaining funds to the customer, thereby converting the funds. The complaint also alleges that Mize failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C07030072)

**David Keith Rust (CRD #3256546, Registered Representative, Dallas, Texas)** was named as a respondent in an NASD complaint alleging that he directed public customers to make withdrawals from their securities accounts in the form of checks totaling \$436,000, and instructed the customers to endorse the checks and give them to him to invest on their behalf. The complaint also alleges that Rust endorsed the customers' checks, thereby converting the funds to his own use and benefit without the customers' knowledge or consent. In addition, the complaint alleges that Rust failed to respond to NASD requests for information and documentation. (NASD Case #C06030023)

**Raghavan Sathianathan (CRD #1743692, Registered Representative, Bloomfield, New Jersey)** was named as a respondent in an NASD complaint alleging that he recommended and effected the purchase of mutual funds and index warrants in the accounts of public customers without having reasonable grounds for believing that such transactions were suitable for the customer in view of the dollar amount of the shares purchased, the nature of the recommended transactions, and the customers' financial situation, investment objectives, circumstances, and needs. The complaint alleges that the transactions were effected through the use of margin, which was unsuitable in view of the size and nature of the accounts, financial situation, and needs. In addition, the complaint alleges Sathianathan recommended that the customer use an unsuitable stock as margin collateral for the purchase of the class B shares that was not suitable for the customer in view of his financial situation, investment objectives, circumstances, and needs, and he received commissions due to the unsuitable recommendations. The complaint further alleges that Sathianathan, by use of the instrumentalities of interstate commerce or the mails, intentionally or recklessly employed devices to defraud customers by making untrue statements of material facts or omitting material facts necessary to make the statements, in light of the circumstances in which they were made, not misleading. The complaint also alleges that Sathianathan, pursuant to verbal authority, exercised discretion in the account of a public customer, without having obtained prior written authorization from the customers and prior written acceptance of the account as discretionary by his member firm. (NASD Case #C9B030076)

**Stephen Nicholas Thomas (CRD #3236045, Registered Representative, Brooklyn, New York)** was named as a respondent in an NASD complaint alleging that he received \$150 from public customers in payment of initial insurance premiums on life insurance policies and failed to remit the funds to his member firm, thereby converting the money for his own use and benefit or for the benefit of a third party. (NASD Case #C10030082)

**Scott Emil Wiard (CRD #1509365, Registered Principal, Ypsilanti, Michigan) and James David Reisinger (CRD #1275258, Registered Principal, Dexter, Michigan)** were named as respondents in an NASD complaint alleging that Wiard was unconditionally prohibited from maintaining discretionary customer accounts, but individually, and through a registered investment adviser, continued to maintain and exercise discretion over customer accounts. The complaint alleges that Wiard and Reisinger engaged in unauthorized transactions in the accounts of public customers by fully investing customer assets in stock funds contrary to instructions and beyond the scope of authority granted by public customers. The complaint further alleges that Wiard and Reisinger recommended and engaged in purchase and sale transactions in the accounts of public customers without reasonable grounds for believing that the recommendations and resultant transactions were suitable for each of the customers on the basis of their age, net worth, financial situation, investment objectives, and needs. Furthermore, the complaint alleges that respondents created and distributed a brochure that touted the market-timing program they developed, and failed to obtain approval by signature or initial by a registered principal of their member firm prior to the use of the brochure, nor was the material sent to NASD Advertising Regulation for review and approval within 10 days of first use.

The complaint also alleges that the brochure omitted material information necessary to provide a sound basis for evaluating the facts regarding an investment system. The complaint further alleges that Wiard and Reisinger produced and distributed a letter that was deficient in the following respects: material disclosure; the NASD member firm name was placed in a legend on the last page of the letter; the letter, which names a non-member entity in addition to the member firm, failed to make it clear that securities are offered through the firm; and the material was not approved prior to use by a registered principal of the firm. The complaint further alleges that Wiard failed to amend his Form U4 to reflect the receipt of customer complaints. (NASD Case #C8A030078)

**Terry Michael Laymon (CRD #304342, Registered Principal, Harper Woods, Michigan)** was named as a respondent in an NASD complaint alleging that he retained ownership and control of a member firm and associated with the firm in a principal capacity while he was subject to a disqualification. The complaint also alleges that Laymon intentionally, recklessly, or negligently created false account statements with incorrect or inflated valuations to induce a public customer to continue to maintain accounts with Laymon's member firm. The complaint further alleges that a member firm, acting through Laymon, failed to qualify and register as a person associated with the firm, a financial and operations principal, or an introducing broker/dealer financial and operations principal. In addition, the

complaint alleges that Laymon performed duties as a general security principal while his registration status with NASD was inactive due to failure to timely complete the Regulatory Element of NASD's Continuing Education Rule. Furthermore, the complaint alleges that Laymon failed to timely file Rule 3070 reports disclosing reportable events. The complaint also alleges that a member firm, acting through Laymon, failed to timely amend the firm's Form BD and Laymon's Form U4 to report disciplinary actions. In addition, the complaint alleges that Laymon, acting through the firm, failed to timely amend his Form U4 to report disciplinary actions, and failed to respond completely and timely to NASD requests for information and documents. (NASD Case #C8A030081)

### **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 8221. 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.

<b>Blue Marble Financial, LLC</b> Irving, Texas (October 2, 2003)	<b>Hopewell Capital Group, Inc.</b> Montvale, New Jersey (October 14, 2003)
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### **Firm Suspended for Failure to Pay Arbitration Fees Pursuant to NASD Rule 9531**

**Indianapolis Securities, Inc.**  
Valley Stream, New York  
(November 4, 2003)

### **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.)

<b>Angelou, Morris,</b> Rego Park, New York (October 17, 2003)	<b>Spear, James B.</b> Evansville, Indiana (October 3, 2003)
<b>Kiggins, Warren D.</b> Phoenix, Arizona (September 17, 2003)	<b>Stewart, Stephen R.</b> Cary, North Carolina (October 6, 2003)
<b>Pagano, Brian Joseph</b> West Islip, New York (October 17, 2003)	<b>Tanner, Jr., Thomas</b> Hartselle, Alabama (October 20, 2003)

### **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.)

<b>Ceparano, Louis C.</b> Melville, New York (October 22, 2003)	<b>Millard, John L.</b> Jupiter, Florida (October 6, 2003)
<b>Chenhall, Terry</b> St. Petersburg Beach, Florida (October 6, 2003)	<b>Mongie, Francis</b> Provo, Utah (October 10, 2003)
<b>Everin, Peggy Louise</b> Wyoming, Michigan (October 17, 2003)	<b>Ricciardi, Jr., Elio</b> Staten Island, New York (October 17, 2003)
<b>Lyster, Charles E.</b> San Clemente, California (October 13, 2003)	<b>Stabile, Bach R.</b> Sherman Oaks, California (October 17, 2003)
<b>McMaster, Samuel</b> Albuquerque, New Mexico (September 17, 2003)	<b>Wegesser, Hans</b> Menomonee Falls, Wisconsin (October 17, 2003)

### **Individual Suspended Pursuant to NASD Rule Series 9510 for Failure to Comply With an Arbitration Award or a Settlement Agreement**

(The date the suspension began is listed after the entry. If the suspension has been lifted, the date follows the suspension date.)

<b>Hobika, Matthew,</b> Boston, Massachusetts (October 23, 2003)	<b>Masel, Patricia,</b> North Babylon, New York (October 15, 2003 – October 20, 2003)
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## **NASD Charges Morgan Stanley with Giving Preferential Treatment to Certain Mutual Funds in Exchange for Brokerage Commission Payments**

NASD announced that it sanctioned Morgan Stanley DW Inc., for giving preferential treatment to certain mutual fund companies in return for millions of dollars in brokerage commissions. This is the second action brought by NASD against the firm for mutual fund violations in the last two months and is part of NASD's broader effort to crack down on sales practice abuses in this area. In conjunction with a related action filed by the Securities and Exchange Commission (SEC), Morgan Stanley agreed to resolve the NASD and SEC actions by paying \$50 million in civil penalties and surrendered profits.

From January 2000 until this year, Morgan Stanley operated two programs—the Asset Retention Program and the Partners Program—in which it gave favorable treatment to products offered by as many as 16 mutual fund companies out of a total of more than 115 fund complexes that could be sold by the firm's sales force. In return for these brokerage commissions and other payments, mutual fund companies received preferential treatment by Morgan Stanley, which included:

Placement on a "preferred list" of funds that financial advisors were to look to first in making recommendations of fund products;

Higher visibility on Morgan Stanley's sales systems and workstations than non-paying funds;

Eligibility to participate in the firm's 401(k) programs and to offer offshore fund products to Morgan Stanley customers;

Better access to its sales force and branch managers; and

Payment of special sales incentives to Morgan Stanley financial advisors.

In addition, the participating mutual fund companies paid Morgan Stanley an extra 15 to 20 basis points on each sale. This was over and above the normal fees earned by the firm for selling the funds.

This extra compensation paid to Morgan Stanley for the preferential treatment included millions of dollars paid by the mutual funds through commissions charged by the firm for trades it executed for the funds. These commissions were sufficiently large to pay for the special treatment, as well as the costs of trade execution. This conduct violates NASD's "Anti-Reciprocal Rule," Conduct Rule 2830(k), which prohibits members from favoring the distribution of shares of particular mutual funds on the basis of brokerage commissions to be paid by the mutual fund companies, as well as allowing sales personnel to share in directed brokerage commissions. One important purpose of the rule is to help eliminate conflicts of interest in the sale of mutual funds.

"More than 95 million investors in this country depend on mutual funds as their entryway into our securities markets. Investors expect and are entitled to informed, objective, and untainted recommendations from their brokers and their firms when it comes to which mutual funds to buy," said Mary L. Schapiro, NASD Vice Chairman and President of Regulatory Policy and Oversight. "Today's enforcement actions send a clear message that those who choose to embrace commissions, higher payouts, and extra bonuses over their duty to render conflict-free advice to their customers will be sanctioned in the strongest of terms."

In September of this year, Morgan Stanley DW was censured and fined \$2 million by NASD for conducting prohibited sales contests for its brokers and managers to promote the sale of its own mutual funds (see related news release at [http://www.nasdr.com/news/pr2003/release\\_03\\_039.html](http://www.nasdr.com/news/pr2003/release_03_039.html)).