

NOVEMBER 2003

Notices to Members

Notices

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Disciplinary and Other NASD Actions

Reported for November D1



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Notice to Members

NOVEMBER 2003

SUGGESTED ROUTING

Legal and Compliance
Registered Representatives
Senior Management

KEY TOPICS

Charges for Services Performed
Fee-Based Compensation
NASD Rule 2110
NASD Rule 2430

ACTION REQUIRED

Fee-Based Compensation

NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate

Executive Summary

Fee-based programs typically charge a customer a fixed fee or percentage of assets under management in lieu of transaction-based commissions. While NASD recognizes the benefits these programs offer for many customers, they are not appropriate in all circumstances. NASD therefore reminds members that they must have reasonable grounds for believing that a fee-based program is appropriate for a particular customer, taking into account the services provided, cost, and customer preferences.

Questions/Further Information

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

Background and Discussion

NASD members increasingly are offering customers fee-based accounts that charge a fixed fee and/or percentage of assets under management ("fee-based programs") as an alternative to traditional commission-based charges for brokerage services. Many of these members have expanded their fee-based programs to cover traditional brokerage accounts that do not include investment advisory services.¹ Previously, these programs typically involved "wrap" accounts, where broker/dealers provide investors with

a suite of services—asset allocation, portfolio management, execution and administration—for a single fee. Most traditional wrap accounts are considered advisory accounts subject to the Investment Advisers Act.²

The 1995 Report of the Committee on Compensation Practices (the “Tully Report”)³ labeled fee-based programs a “best practice” because they more closely align the interests of the broker/dealer and customer and reduce the likelihood of abusive sales practices such as churning, high-pressure sales tactics, and recommending unsuitable transactions.⁴ The Tully Report noted that fee-based programs are particularly appropriate for investors who prefer consistent and explicit monthly or annual charges and those that engage in at least a moderate level of trading activity.

On the other hand, the Tully Report acknowledged that fee-based programs may not fit the needs of certain investors. In this regard, commenters to the Tully Committee noted that accounts with low trading activity may be better off with a commission-based program. These accounts might include those comprised mainly of bonds or mutual funds, but also could contain individual capital appreciation equities where the customer has a stated buy-and-hold strategy.

Fee-Based Accounts Must Be Appropriate

It generally is inconsistent with just and equitable principles of trade—and therefore a violation of Rule 2110—to place a customer in an account with a fee structure that reasonably can be expected to result in a greater cost than an alternative account offered by the member that provides the same services and benefits to the customer.⁵ Accordingly, before opening a fee-based account for a customer, members must have reasonable grounds to believe that such an account is appropriate for that particular customer. To that end, members should make reasonable efforts to obtain information about the customer’s financial status, investment objectives, trading history, size of portfolio, nature of securities held, and account diversification. With that and any other relevant information in hand, members should then consider whether the type of account is appropriate in light of the services provided, the projected cost to the customer, alternative fee structures that are available, and the customer’s fee structure preferences. In addition, members should disclose to the customer all material components of the fee-based program, including the fee schedule, services provided, and the fact that the program may cost more than paying for the services separately.

NASD recognizes that factors other than cost may properly be considered to determine whether an account is appropriate for a customer. Thus, for example, a customer may place a premium on the positive characteristics of fee-based programs identified in the Tully Report: having his or her interests aligned with that of the member and registered representative and the certainty and consistency of cost that many fee-based programs provide. These non-price factors may constitute significant benefits to a particular customer; therefore, a member may give them corresponding weight in determining the appropriateness of a fee-based account for that customer. Even where a fee-based account is determined to be appropriate, members still must comply with their longstanding obligations under Rule 2430.⁶

Absent inducement by the member, no liability under Rule 2110 (unless derivative of another rule violation) will attach to a member where it is disclosed to a customer that a potentially lower cost account is available, but the member can demonstrate that the customer nevertheless opted for a fee-based account for reasons other than pricing.⁷ In such circumstances, the member should document the fact that the customer chose a fee-based account for reasons other than cost.

Supervisory Procedures

Members should implement supervisory procedures to require a periodic review of fee-based accounts to determine whether they remain appropriate for their respective customers.⁸ As part of that review, members should consider whether reasonable assumptions about market conditions upon which the member based its initial determination of appropriateness have changed, as well as any changes in customer objectives or financial circumstances.

Members also may wish—but are not required—to create reports that compare the asset-based fees to those that would have been generated in the same account on a commission basis. Since the appropriateness of a fee can be based upon factors other than cost to the customer, a retrospective finding that a customer would have been charged less in a commission-based account is not conclusive that the account is inappropriate for that customer. However, such a finding should cause the member to give careful scrutiny to those issues. Finally, members should review their sales literature, marketing material, and other correspondence related to fee-based programs to ensure the information is balanced and not misleading, and should include in training materials guidelines regarding the establishment of fee-based accounts.

Endnotes

1 A 1999 SEC proposal to specifically exempt from the Investment Advisers Act these fee-based brokerage programs is awaiting final action. Under the proposal, only non-discretionary accounts where incidental advice is provided would be exempt. Exchange Act Release No. 42099 (November 4, 1999).

2 This *Notice to Members* is focused on brokerage accounts that do not require registration under the Investment Advisers Act, but members nonetheless must ensure that advisory products and services are appropriate for a customer and that charges for such services are reasonable.

In determining whether a broker/dealer meets the definition of "investment adviser," the SEC has excluded circumstances where advice given

is solely incidental to typical brokerage services, such as execution and administration. The SEC has commented that the exception "amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business and that it would be inappropriate to bring them within the scope of the [Advisers Act] merely because of this aspect of their business." Exchange Act Release No. 34-42099 (November 4, 1999).

3 SEC Committee on Compensation Practices, Report on Broker-Dealer Compensation (April 10, 1995), available at www.sec.gov/news/studies.shtml (last modified July 25, 2003).

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- 4 Fee-based programs do not always align the interests of representative and customer: for example, income-producing securities may be more appropriate for certain investors, but because such securities may result in lower fees than would be produced by a portfolio of capital appreciation stocks, there could be an economic disincentive to recommend these securities. Some commenters also have expressed concern that fee-based programs might encourage account neglect. These concerns are most pronounced when the registered representative has discretionary authority over the account.
 - 5 Depending on the facts and circumstances surrounding the establishment of, and transactions in, a fee-based account, failure to obtain and assess for suitability the aforementioned information could result in a violation of Rule 2310. See *Wendell Belden*, Exchange Act Release No. 47859 (May 14, 2003). NASD construes *Belden* as supporting the principle that the manner of purchase of a recommended security by an associated person, where that security otherwise would be suitable based on the investor's investment objectives, risk tolerance, and financial means, can render that recommendation unsuitable, and therefore violative of 2310, if there is an alternative basis upon which the security can be purchased to the pecuniary advantage of the investor.
 - 6 Rule 2430 requires that charges for services "shall be reasonable and not unfairly discriminatory between customers." See *Notices to Members 92-11* and *75-65*. In referring to the predecessor rule to current Rule 2430, *Notice to Members 75-65* states that charges must be "fair under the relevant circumstances and a member should be prepared to justify that its prices are fair as to each customer and transaction." This standard remains applicable today.
 - 7 Evidence of such disclosure does not, by itself, demonstrate that a customer opted for a fee-based account for non-pricing reasons. A member must also establish the specific reasons given by the customer for choosing a fee-based account after receiving the disclosure.

Customer consent is not a defense to an otherwise unsuitable recommendation pursuant to Rule 2310 and therefore would be irrelevant if the facts established a suitability violation in accordance with the *Belden* decision.
 - 8 NASD believes that, absent unusual circumstances, it would be reasonable to conduct a review annually. Of course, reviews undertaken with greater frequency may prove to be of greater benefit to members and their customers. On those occasions where members review their customer accounts for business reasons, including determining profitability, they may not ignore relevant information related to whether the account is appropriate for the customer because the review was not conducted for that purpose.

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Notice to Members

NOVEMBER 2003

SUGGESTED ROUTING

Executive Representative
Legal & Compliance
Operations
Senior Management

KEY TOPICS

Transaction Reporting
Electronic Communication Networks

ACTION REQUIRED

Electronic Communications Networks

SEC Approves Changes to Rules on Reporting of Transactions through Electronic Communications Networks (ECNs); **Changes Effective November 10, 2003**

Executive Summary

NASD is issuing this *Notice* to replace and supersede *Notice to Members (NtM) 03-55*, which discussed the SEC's approval of rules on reporting of transactions executed through electronic communications networks (ECNs). The effective date of the rules was originally October 6, 2003, but was delayed until November 10, 2003. Minor amendments to the rules have since been filed with the Securities and Exchange Commission (SEC) on an immediately effective basis, and are reflected in this *Notice*. This *Notice* also repeats information that is in *NtM 03-55*.

On September 4, 2003, the SEC approved changes to rules governing the reporting of transactions through Nasdaq's Automated Confirmation Transaction Service (ACT) in order to clarify the reporting requirements applicable to transactions conducted through electronic communications networks (ECNs).

The new rules do not apply to trades reported through NASD's Trade Reporting and Comparison Service (TRACS). The changes, which take effect **November 10, 2003**, describe the three methods that may be used by ECNs and/or their customers to report trades executed through an ECN's facilities. ECNs that use ACT to report some or all of the transactions executed through their facilities are required to file a notice of their trade-reporting methods prior to **November 10, 2003**. Please use Attachment A to file this notice. Notices must be filed with NASDAQ's MarketWatch Department, 9509 Key West Avenue, Rockville, MD 20850, Attention: Sheila Dagucon (or you may fax the notification to (240) 386-6050); and NASD's Market Regulation Department, 9509 Key West Avenue, Rockville, MD 20850, Attention: Alternative Trading Systems Group (or you may fax the notification to (240) 386-5139).

03-69

Questions/Further Information

Questions regarding this *Notice* may be directed to Sheila Dagucon, NASDAQ MarketWatch, at (240) 386-6049; or John Yetter, NASDAQ Office of General Counsel, at (202) 912-3039.

Background

Current practices of ECN trade reporting have developed over time in conjunction with the growth of the number of ECNs. As each new ECN entered the market, it registered under NASD Rule 4623 and informed NASDAQ and NASD concerning its planned method for reporting transactions. Although the use of different reporting methodologies by different ECNs has generally allowed ECNs to fulfill reporting obligations while tailoring their methodology to their own business needs and those of their subscribers, the absence of clearly defined rules has, in some circumstances, created confusion as to the trade reporting responsibilities of ECNs and their subscribers. The rule change approved by the Commission will provide members greater certainty concerning their trade reporting responsibilities, while allowing ECNs to continue using the various methods of trade reporting that have developed over time.

The rule change is based on NASDAQ's understanding of the different methods used by ECNs today to report trades, and, in general, the rule change is not intended to require ECNs to modify their current trade-reporting practices. Rather, the purpose of the rule change is to codify these practices in the form of clear, enforceable rules that will provide greater guidance to market participants. The rule change will apply to transactions in all securities that are executed through an ECN and reported to ACT.

The rule change permits ECNs to use any of three methods for reporting transactions. However, each ECN must inform, in writing, NASD and NASDAQ simultaneously which method it will use for reporting trades to ACT for each of its subscribers, although it may change its method at any time by providing advance written notice simultaneously to NASD and NASDAQ.

First, an ECN may assume sole responsibility for reporting transactions executed through its facilities and identify itself as the reporting party.

Second, an ECN may assume sole responsibility for transaction reporting, but identify a subscriber as the reporting party. In that case, the identified reporting party would be determined in accordance with the existing rules for allocating trade-reporting responsibility in NASD Rule 6130(c). Thus, if the subscribers conducting a transaction through the ECN were both market makers or both Order Entry Firms, the selling party would be identified as the reporting party; if the transaction were between a market maker and an Order Entry Firm, the market maker would be identified as the reporting party; and if the transaction were between a member (*i.e.*, a broker/dealer) and a non-member (such as an institutional investor), the member would be identified as the reporting party.

Third, the ECN may impose some or all of the responsibility for reporting on its subscribers. In that case, the ECN would notify the appropriate reporting party, determined in accordance with the existing rules of priority for trade reporting in NASD Rule 6130(c), that it had an obligation to submit a report concerning the trade.

At any given time, an ECN may utilize more than one of these methods, with the choice of the method varying depending on the needs of particular subscribers. Thus, an ECN may use one method for one of its subscribers and a different method for all of its other subscribers. The ECN must, however, provide simultaneously NASD and NASDAQ advance written notice concerning the method that it will use for each subscriber.

In each case, the party submitting a trade report is responsible for ensuring its accuracy and completeness, by providing the information specified by Rule 6130(d). In addition, when an ECN submits a trade report identifying another party as the reporting party, both the ECN and the identified reporting party are responsible for ensuring the accuracy and completeness of the report.

The rule change also addresses procedures for reporting transactions in several unique circumstances associated with ECNs. First, the rule change provides that when the parties to a transaction executed through an ECN are both non-members, the ECN must submit all required trade reports and identify itself as the reporting party. This is the case because, as non-members, the parties to the transaction would not be eligible to report trades through ACT. Second, in circumstances where one ECN routes an order to another ECN that executes the order, the ECN that executes the order would be responsible for reporting the transaction, or requiring a subscriber to report the transaction, in accordance with one of the three basic methods for trade reporting described above. For purposes of the rules for allocating trade-reporting responsibility between ECN subscribers, the routing ECN would be deemed to be an Order Entry Firm. Thus, if the executing ECN uses the second method of trade reporting (*i.e.*, reporting on behalf of its subscribers), and it receives an order from a routing ECN that is matched against the order of an Order Entry Firm or another ECN, the sell side would be identified as the reporting party. If the executing ECN matched the routed order against the order of a market maker, however, the market maker would be identified as the reporting party.

Finally, it should be noted that the rule change applies only to transactions that are reported to ACT, since NASDAQ does not have authority to establish rules governing the reporting of trades to non-NASDAQ systems, including NASD's TRACS system. Thus, in circumstances where an ECN has the option to report trades to ACT or to another trade-reporting system, such as NASD's TRACS system, the rule does not mandate that the ECN use ACT for trade reporting. However, to the extent that the ECN or its subscribers opt to use ACT to report a particular transaction, all provisions of the rule change would apply to that transaction.

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Trade-reporting methods:

1. The ECN submits trade reports to ACT and identifies itself as the reporting party (NASD Rule 6130(c)(5)(A)).
2. The ECN submits trade reports to ACT on behalf of the reporting party and identifies the reporting party in accordance with the rules for determining reporting parties reflected in NASD Rule 6130(c)(1), (2), (3), and (4) (NASD Rule 6130(c)(5)(B)).
3. The ECN requires one of the parties to a transaction, determined in accordance with the rules for determining reporting parties reflected in NASD Rule 6130(c)(1), (2), (3), and (4), to submit the trade reports to ACT (NASD Rule 6130(c)(5)(C)).

Notice should be sent to:

- ▶ NASDAQ's MarketWatch Department
9509 Key West Avenue
Rockville, MD 20850

Or you may fax the notification to (240) 386-6050

Attention: Sheila Dagucon

AND

- ▶ NASD's Market Regulation Department
9509 Key West Avenue
Rockville, MD 20850

Or you may fax the notification to (240) 386-5139

Attention: Alternative Trading Systems Group

ATTACHMENT B — TEXT OF AMENDMENTS

New text is underlined; deletions are in brackets.

5400. NASDAQ STOCK MARKET AND ALTERNATIVE DISPLAY FACILITY TRADE REPORTING

* * * * *

5430. Transaction Reporting

(a) No change.

(b) Which Party Reports Transaction and to Which Facility

(1) In transactions between two Registered Reporting Nasdaq Market Makers, the member representing the sell side shall report the trade using ACT.

(2) In transactions between a Registered Reporting Nasdaq Market Maker and a Non-Registered Reporting Member, the Registered Reporting Nasdaq Market Maker shall report the trade using ACT.

(3) In transactions between two Non-Registered Reporting Members, the member representing the sell side shall report the trade using ACT or TRACS.

(4) In transactions between a member and a customer, the member shall report as follows:

(A) A Registered Reporting Nasdaq Market Maker shall report the trade using ACT;

(B) A Registered Reporting ADF Market Maker shall report the trade using TRACS; and

(C) A Non-Registered Reporting Member shall report the trade using ACT or TRACS.

(5) In transactions between two Registered Reporting ADF Market Makers, the member representing the sell side shall report the trade using TRACS.

(6) In transactions between a Registered Reporting ADF Market Maker and a Non-Registered Reporting Member, the Registered Reporting ADF Market Maker shall report the trade using TRACS.

(7) In transactions between a Registered Reporting Nasdaq Market Maker and a Registered Reporting ADF Market Maker, the member representing the sell side shall report as follows:

(A) A Registered Reporting Nasdaq Market Maker shall report the trade using ACT; and

(B) A Registered Reporting ADF Market Maker shall report the trade using TRACS.

(8) If a member simultaneously is a Registered Reporting Nasdaq Market Maker and a Registered Reporting ADF Market Maker, and has the trade reporting obligation pursuant to paragraphs (1), (2), (4), (5), (6), or (7), the member can report the trade using either ACT or TRACS, unless the trade is executed using ACES; the Nasdaq National Market Execution System ("NNMS"); [the SelectNet Service; the SmallCap Small Order Execution System ("SOES");] or the Primex Auction System ("Primex"). A trade executed using ACES must be reported using ACT, and trades executed using NNMS[, SelectNet, SOES,] or Primex will be reported to ACT automatically.

(9) In transactions conducted through an ACT ECN (as defined in Rule 6110) that are reported to ACT, the ACT ECN shall ensure that transactions are reported in accordance with Rule 6130(c). If an ACT ECN is also a Registered Reporting ADF ECN (as defined in Rule 4200A), Rule 6130(c) shall apply only to transactions conducted through the ECN for which trade reports are submitted to ACT.

* * * * *

6100. AUTOMATED CONFIRMATION TRANSACTION SERVICE (ACT)

6110. Definitions

(a) – (p) No change.

(q) The term "ACT ECN" shall mean a member of the Association that is an electronic communications network that is a member of a registered clearing agency for clearing or comparison purposes or has a clearing arrangement with such a member, to the extent that transactions executed through it are reported to ACT.

* * * * *

6130. Trade Report Input

(a) – (b) No change.

(c) Which Party Inputs Trade Reports to ACT

ACT Participants shall, subject to the input requirements below, either input trade reports into the ACT system or utilize the Browse feature to accept or decline a trade within the applicable time-frames as specified in paragraph (b) of this Rule. Trade data input obligations are as follows:

(1) in transactions between a Market Maker and an Order Entry Firm, the Market Maker shall be required to submit a trade report to ACT;

(2) in transactions between two Market Makers, the member representing the sell side shall be required to submit a trade report to ACT;

(3) in transactions between two Order Entry Firms, the member representing the sell side shall be required to submit a trade report to ACT[.];

(4) in transactions between a member and a customer, the member shall be required to submit a trade report to ACT;

(5) in transactions conducted through an ACT ECN that are reported to ACT, the ACT ECN shall ensure that transactions are reported in accordance with one of the following methods:

(A) the ACT ECN shall submit the trade reports to ACT and identify itself as the reporting party;

(B) the ACT ECN shall submit the trade reports to ACT on behalf of the reporting party and identify the reporting party in accordance with the rules for determining reporting parties reflected in paragraphs (1), (2), (3), and (4) above; or

(C) the ACT ECN shall require one of the parties, determined in accordance with the rules for determining reporting parties reflected in paragraphs (1), (2), (3), and (4) above, to submit the trade reports to ACT.

When an ACT ECN reports transactions in accordance with subparagraph (A), the ACT ECN shall be responsible for ensuring that the trade reports are accurate and contain all information required by subsection (d) of this rule for both the ACT ECN and the identified non-reporting party. When an ACT ECN reports transactions in accordance with subparagraph (B), both the ACT ECN and the party identified as the reporting party shall be responsible for ensuring that the trade reports are accurate and contain all information required by subsection (d) of this rule for both the ACT ECN and the identified reporting party. When an ACT ECN requires reporting of transactions in accordance with subparagraph (C), the reporting party shall be responsible for ensuring the accuracy and completeness of the trade report.

An ACT ECN shall provide written notice to the Association of the method of trade reporting used by the ACT ECN for each of its subscribers, and may change the method of trade reporting used for a subscriber by providing advance written notice of the change to the Association;

(6) in transactions conducted through two ACT ECNs or an ACT ECN and an ECN that is not an ACT ECN, an ACT ECN shall be responsible for complying with the requirements of paragraph (5) above for reporting a transaction executed through its facilities, and an ECN that routed an order to it for execution shall be deemed to be an Order Entry Firm and a member for purposes of the rules for determining reporting parties reflected in paragraphs (1), (3), and (4) above; and

(7) in transactions conducted through an ACT ECN in which neither of the parties is a member, the ACT ECN shall report the transaction in accordance with the requirements of subparagraph (5)(A) above.

(d) Trade Information To Be Input

Each ACT report shall contain the following information:

- (1) Security identification symbol of the eligible security (SECID);
- (2) Number of shares;
- (3) Unit price, excluding commissions, mark-ups or mark-downs;
- (4) Execution time for any transaction in Nasdaq or CQS securities not reported within 90 seconds of execution;
- (5) A symbol indicating whether the party submitting the trade report represents the Market Maker side or the Order Entry side;
- (6) A symbol indicating whether the transaction is a buy, sell, sell short, sell short exempt or cross;
- (7) A symbol indicating whether the trade is as principal, riskless principal, or agent;
- (8) Reporting side clearing broker (if other than normal clearing broker);
- (9) Reporting side executing broker as "give-up" (if any);
- (10) Contra side executing broker;
- (11) Contra side introducing broker in case of "give-up" trade;

(12) Contra side clearing broker (if other than normal clearing broker).

(13) For any transaction in an order for which a member has recording and reporting obligations under Rules 6954 and 6955, the trade report must include:

(A) An order identifier, meeting such parameters as may be prescribed by the Association, assigned to the order that uniquely identifies the order for the date it was received (see Rule 6954(b)(1)).

(B) The time of the execution expressed in hours, minutes, and seconds. This information must be reported regardless of the period of time between execution of the trade and the ACT trade report. All times reported to the ACT system shall be in Eastern Time.

(e) Aggregation of Transaction Reports

Individual executions of orders in a security at the same price may be aggregated, for ACT reporting purposes, into a single report if the transactions are with the identical contra party; provided, however, that a reporting party may not withhold reporting a trade in anticipation of aggregating the transaction with other transactions.

* * * * *

6400. REPORTING TRANSACTIONS IN LISTED SECURITIES

* * * * *

6420. Transaction Reporting

(a) No change.

(b) Which Party Reports Transaction

(1) Transactions executed on an exchange are reported by the exchange and shall not be reported by members.

(2) In transactions between two Registered Reporting Members, only the member representing the sell side shall report.

(3) In transactions between a Registered Reporting Member and a Non-Registered Reporting Member, only the Registered Reporting Member shall report.

(4) In transactions between Non-Registered Reporting Members, only the member representing the sell side shall report.

(5) In transactions conducted through an ACT ECN (as defined in Rule 6110), the ACT ECN shall ensure that the transactions are reported in accordance with Rule 6130(c).

(c) - (e) No change.

IM-6420. Transactions in Eligible Securities

Summary Of Provisions Governing Members' Requirements To Report Transaction In Eligible Securities

Chart 1 — General Reporting Requirements Under Rule 6420(b)

Member	Transaction	Member Reports When Contra-Party Is			
		[Designated] Registered Reporting	Member	Member	Exchange
[Designated] Registered Reporting Member	buys from:	No	Yes	No	Yes
	sells to:	Yes	Yes	No	Yes
Non-[Designated] Registered Reporting Member	buys from:	No	No	No	Yes
	sells to:	No	Yes	No	Yes
ACT ECN		See 6130(c)	See 6130(c)	No	See 6130(c)

Chart II — Reporting Requirements for "Riskless" Transactions as Defined in Rule 6420(d)(4)

Member	Transaction	Member Reports When Contra-Party Is			
		[Designated] Registered Reporting	Member	Member	Exchange
[Designated] Registered Reporting Member	buys from customer and sells to:	Yes	Yes	No	Yes
	sells to customer and buys from:	No	Yes	No	Yes
Non-[Designated] Registered Reporting Member	buys from customer and sells to:	No	Yes	No	Yes
	sells to customer and buys from:	No	No	No	Yes

* * * * *

6600. REPORTING TRANSACTIONS IN OVER-THE-COUNTER SECURITIES

* * * * *

6620. Transaction Reporting

(a) No change.

(b) Which Party Reports Transaction

(1) In transactions between two OTC Market Makers, only the member representing the sell side shall report.

(2) In transactions between an OTC Market Maker and a Non-Market Maker, only the OTC Market Maker shall report.

(3) In transactions between two Non-Market Makers, only the member representing the sell side shall report.

(4) In transactions between a member and a customer, the member shall report.

(5) In transactions conducted through an ACT ECN (as defined in Rule 6110), the ACT ECN shall ensure that the transactions are reported in accordance with Rule 6130(c), and the term "Market Maker" as used in such rule shall be construed to include an OTC Market Maker.

(c) - (e) No change.

* * * * *

6900. REPORTING TRANSACTIONS IN DIRECT PARTICIPATION PROGRAMS

* * * * *

6920. Transaction Reporting.

(a) No change.

(b) Which Party Reports Transactions

(1) In transactions between two members, only the member representing the sell side shall report.

(2) In transactions between a member and a customer, the member shall report.

(3) In transactions conducted through an ACT ECN (as defined in Rule 6110), the ACT ECN shall ensure that the transactions are reported in accordance with Rule 6130(c); provided that for purposes of Rule 6130(c)(5) (B) and (C), the party with the reporting obligation shall be as set forth in Rule 6130(c)(3) and the term "Order Entry Firm" as used in such rule shall be construed to refer to any member.

(c) – (e) No change.

Notice to Members

NOVEMBER 2003

SUGGESTED ROUTING

Legal & Compliance
Senior Management

KEY TOPICS

Arbitration
Discovery

INFORMATIONAL

Discovery

NASD Reminds Members of Their Duty to Cooperate
in Arbitration Discovery Process

Executive Summary

NASD rules require parties to NASD arbitrations to cooperate in the voluntary exchange of documents and information, and to respond to discovery requests from other parties within a certain time. In addition, the NASD *Discovery Guide* and Document Production Lists specify which documents are presumed to be discoverable in customer disputes. Absent a written objection, or an agreement by the parties to the contrary, parties must exchange documents listed on applicable Document Production Lists within the specified time frames.

NASD has become increasingly aware of instances in which parties are not complying with their duty to cooperate in the exchange of documents requested by parties or listed on applicable Document Production Lists within the specified time. NASD will not tolerate abuses of the discovery process. NASD is issuing this *Notice to Members* to: (1) remind members and associated persons of that duty; and (2) notify them that NASD Dispute Resolution will continue to monitor compliance with its discovery rules, and will refer perceived abuses to NASD Regulatory Policy and Oversight for disciplinary review.¹

Questions/Further Information

Questions regarding this *Notice* may be directed to Laura Gansler, Counsel, NASD Dispute Resolution, at (202) 728-8275, or via e-mail, laura.gansler@nasd.com.

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Discussion

Rule 10321(a) of the NASD Code of Arbitration Procedure (Code) provides that “[t]he parties shall cooperate to the fullest extent practicable in the voluntary exchange of documents and information to expedite the arbitration.” Rule 10321(b) provides that parties may request documents or information from one another, and that a party has 30 days to produce or object to the production of documents or information requested by a party. Rule 10321(b) also states that parties must try to resolve any dispute regarding the production of the documents or information before objecting under the rule.

In addition to these rules, the NASD *Discovery Guide* provides guidance to parties in NASD arbitrations regarding documents that should be exchanged automatically, without arbitrator or staff intervention, and includes timetables and procedures for the exchange of such documents. The *Discovery Guide* includes Document Production Lists that specifically identify which documents are presumed to be discoverable in customer disputes. Document Production Lists 1 and 2 apply to all customer disputes, while Lists 3 through 14 apply to specific types of claims. The *Discovery Guide* makes clear that, absent a written objection, or an agreement by the parties to the contrary, parties must exchange documents listed on applicable Document Production Lists within the specified time frames.

Despite the guidance provided in the Code and the *Discovery Guide*, NASD continues to receive complaints regarding possible abuses of the discovery process. One measure of the problem is the increasing frequency with which arbitration panels have imposed sanctions for discovery abuse. In October 2003, an arbitration panel sanctioned a member \$10,000 a day for each day that the firm continued to withhold documents that the panel ordered the firm to produce. Other recent examples of discovery sanctions include:

- ◆ A panel found that a member firm intentionally concealed documents, delaying the discovery process. The panel assessed the firm over \$10,000 in sanctions and \$2,500 in attorney’s fees.
- ◆ A panel awarded the claimant over \$7,000 due to a member firm’s failure to cooperate in the discovery process.
- ◆ A panel awarded the claimant \$2,750 in attorney’s fees as a sanction for the member’s failure to provide discoverable material.
- ◆ A panel awarded the claimant \$3,000 in sanctions for a respondent’s failure to provide discoverable material as ordered by the panel.
- ◆ A panel sanctioned a member \$10,000 for failure to produce documents required by the chairperson of the panel.

The increasing frequency with which arbitration panels are awarding monetary sanctions for discovery abuse, as well as increasing complaints from parties, leads NASD to conclude that discovery abuse is on the rise. This trend suggests that some parties believe that noncompliance with their duty to cooperate in the discovery process—to voluntarily turn over documents listed on applicable Document Production Lists, or requested by other parties under Rule 10321—is a routine and acceptable part of arbitration strategy. NASD is also concerned that these parties may not be deterred by monetary sanctions alone.

This is a trend that NASD will not tolerate. Discovery abuse hinders the efficient and cost-effective resolution of disputes in this forum, and undermines the integrity and fairness of the NASD forum.

Arbitrators have several tools available for addressing discovery abuse, including issuing monetary sanctions during or at the end of an arbitration, striking claims or defenses, and making disciplinary referrals at the end of a case (see Rule 10105). As part of an effort to reduce discovery abuse, NASD has taken several steps recently to enhance arbitrator training regarding these tools. The October 2003 issue of NASD Dispute Resolution's arbitrator newsletter, *The Neutral Corner*, features a front-page article entitled "Proactive Arbitrators Keep the Case Moving" by Robert D. Herschman, which describes several proactive approaches arbitrators may use for handling discovery problems. In addition, NASD Dispute Resolution's new online chairperson training course includes an extensive section on "Managing the Prehearing Discovery Conference." NASD Dispute Resolution is also currently working on the creation of a discovery "mini-course" that will be offered to all arbitrators online during the first quarter of 2004.

Although NASD believes that enhanced arbitrator training will help reduce instances of discovery abuse, NASD also believes that it is important to remind parties of their duty to cooperate in the discovery process, and to comply with the discovery provisions of the Code and the *Discovery Guide*. In addition, NASD Dispute Resolution staff has recently initiated a practice of bringing all alleged discovery abuses to the attention of the Director of Arbitration and the President of NASD Dispute Resolution. These cases will be carefully reviewed and, when appropriate, NASD Dispute Resolution will refer such cases to NASD Regulatory Policy and Oversight for disciplinary review.

NASD hopes that these measures will lead to a significant reduction in the instances of discovery abuse in the forum, and alleviate the need for future rule changes or other additional steps to deter such abuse.

Endnote

- 1 NASD recognizes that claimants as well as respondents may be responsible for discovery abuse. NASD also intends to remind claimants and their representatives of their duty to cooperate with NASD discovery rules and procedures.

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Notice to Members

NOVEMBER 2003

INFORMATIONAL

SUGGESTED ROUTING

Legal/Compliance
Retail
Senior Management
Internal Audit

KEY TOPICS

Advertising and Sales Literature
Due Diligence
Non-Conventional Investments
Suitability

Non-Conventional Investments

NASD Reminds Members of Obligations When Selling Non-Conventional Investments

Executive Summary

In the aftermath of the recent downturn in the equity markets, NASD reviewed the services and products offered by members and observed that retail investors were being offered an array of different investments as alternatives to conventional equity and fixed-income investments. These alternative investments do not fall under a common category; the staff review indicates that brokers and retail investors have shown increased interest in products such as asset-backed securities, distressed debt, and derivative products (for ease of reference these products are collectively referred to as non-conventional investments or "NCIs"). NCIs often have complex terms and features that are not easily understood. NASD staff reminds members that the fact that an investment is an NCI does not in any way diminish a member's responsibility to ensure that such a product is offered and sold in a manner consistent with the member's general sales conduct obligations. This *Notice to Members* reminds members offering NCIs of their obligations to: (1) conduct adequate due diligence to understand the features of the product; (2) perform a reasonable-basis suitability analysis; (3) perform customer-specific suitability analysis in connection with any recommended transactions; (4) provide a balanced disclosure of both the risks and rewards associated with the particular product, especially when selling to retail investors; (5) implement appropriate internal controls; and (6) train registered persons regarding the features, risks, and suitability of these products.

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Questions/Further Information

Questions regarding this *Notice* may be directed to Gary L. Goldsholle, Associate General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8104; or Janene Marasciullo, Senior Attorney, Regulatory Policy and Oversight, NASD, at (202) 974-2978.

Background and Discussion

As a result of the recent downturn in the equity markets and historically low interest rates, brokers and retail investors have been turning to alternative investment vehicles in search of a better return or yield on investments. A review of members indicated that there is an increased interest in a variety of NCIs that have a wide array of terms, conditions, risks, and rewards.¹ Some of these NCIs are marketed as offering greater security or a “guaranteed” return on investments. Other products seek to maximize the potential return on investments. Some of these products have unique features relating to risk and reward that may not be readily understood, especially by retail investors.

For example, certain asset-backed securities and corporate bonds are secured by a range of collateral such as mobile homes, future royalty payments on popular music, payments from consumer credit cards or other consumer goods. The credit risks associated with these myriad forms of collateral are varied and for many non-institutional parties may be difficult to understand and assess. Other NCIs, such as distressed corporate bonds and certain derivative contracts, may be offered to retail investors in an attempt to maximize the return on investment, but they correspondingly may involve greater degrees of risk. These products also tend to have less market liquidity, less transparency as to their pricing and value and may entail significant credit risks that are difficult to understand and assess.

In sum, recent trends indicate that brokers and investors may be turning to NCIs in search of increased yield or return. Although these products may have attractive qualities, it is crucial that members understand the distinct features, and risks and rewards, of any product they sell. Thus, whenever members recommend NCIs to investors, they must take special care to ensure that all registered persons understand the features of the product in order to be in a position to perform the required suitability analysis before executing a transaction. Likewise, members have an obligation to ensure that all marketing materials used by the member provide an accurate and balanced description of the risks and rewards.

NASD is issuing this *Notice to Members* to remind members of their sales conduct obligations.² Given the complex nature of NCIs and the potential for customer harm or confusion, members are cautioned to ensure that their sales conduct procedures fully and accurately address any of the special circumstances presented by the sale of NCIs. Additionally, NASD is concerned that investors, particularly retail investors, may not fully understand the risks associated with these products. Accordingly, NASD reminds members that the sale of NCIs, like more traditional investments, requires them to:

(1) conduct appropriate due diligence with respect to these products; (2) perform a reasonable-basis suitability analysis; (3) perform customer-specific suitability analysis for recommended transactions; (4) ensure that promotional materials used by the member are fair, accurate, and balanced; (5) implement appropriate internal controls; and (6) provide appropriate training to registered representatives that sell these products. Given the complex and, at times, difficult-to-understand nature of NCIs, members should take particular care to assure that they are fulfilling these obligations.

Due Diligence/ Reasonable-Basis Suitability

As NASD noted most recently in *Notice to Members 03-07* (pertaining to hedge fund sales to customers), performing appropriate due diligence is crucial to a member's obligation to undertake the required reasonable-basis suitability analysis.³ A reasonable-basis suitability determination is necessary to ensure that an investment is suitable for some investors (as opposed to a customer-specific suitability determination, discussed below, which is undertaken on a customer-by-customer basis). Thus, the reasonable-basis suitability analysis can only be undertaken when a member understands the investment products it sells. Accordingly, a member must perform appropriate due diligence to ensure that it understands the nature of the product, as well as the potential risks and rewards associated with the product. Moreover, the fact that a member intends to offer an NCI only to institutional investors does not relieve the member of its responsibility to conduct due diligence and a reasonable-basis suitability analysis.

The type of due diligence investigation that is appropriate will vary from product to product. However, there are some common features that members must understand about products before registered representatives can perform the appropriate suitability analysis. These features include, but are not limited to:

- ◆ The liquidity of the product
- ◆ The existence of a secondary market and the prospective transparency of pricing in any secondary market transactions
- ◆ The creditworthiness of the issuer
- ◆ The creditworthiness and value of any underlying collateral
- ◆ Where applicable, the creditworthiness of the counterparties
- ◆ Principal, return, and/or interest rate risks and the factors that determine those risks
- ◆ The tax consequences of the product
- ◆ The costs and fees associated with purchasing and selling the product

Members should examine these and other appropriate factors when conducting due diligence. A member may in good faith rely on representations concerning an NCI contained in a prospectus or disclosure document. However, reliance on such materials alone may not be sufficient for a member to satisfy its due diligence requirements where the content of the prospectus or disclosure document does not provide the member with sufficient information to fully evaluate the risk of the product or to educate and train its registered persons for sales purposes. In such case, the member must seek additional information about the NCI or conclude that the product is not appropriate for sale to the public. In addition, members should ensure that the persons responsible for conducting due diligence have appropriate training and skill to evaluate the terms of the investment as well as the potential risks and benefits.

Customer-Specific Suitability

Members and their associated persons must reasonably believe that the product is a suitable investment prior to making a recommendation to a particular customer. To ensure that a particular investment is suitable for a specific customer, members and their registered persons must examine: (1) the customer's financial status; (2) the customer's tax status; (3) the customer's investment objectives; and (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.⁴

NASD cautions members against relying too heavily upon a customer's financial status as the basis for recommending NCIs. A customer's net worth alone is not necessarily determinative of whether a particular product is suitable for that investor. Given the unique nature of NCIs, these products may present challenges when it comes to a member's duty to dispense its suitability obligation; however, the difficulty in meeting such challenges cannot be considered as a mitigating factor in determining whether members have met their suitability obligations. NCIs with particular risks may be suitable for recommendation to only a very narrow band of investors capable of evaluating and being financially able to bear those risks.

Promotional Materials

Sales materials and oral presentations regarding NCIs must present a fair and balanced picture regarding both the risks and benefits of investing in these products. For example, members may not claim that certain NCI products, such as asset-backed securities, distressed debt, derivative contracts, or other products, offer protection against declining markets or protection of invested capital unless these statements are fair and accurate. Moreover, when promoting the advantages of NCIs, it is critical that members balance their promotional materials with disclosures of the corresponding risks and limitations of the product discussed above in the "Due Diligence/Reasonable Basis Suitability" section of this *Notice*.

Additionally, if applicable, members should provide investors with any prospectus and other disclosure material provided by the issuer or the sponsor. NASD reminds members, however, that simply providing a prospectus or offering memoranda does not cure unfair or unbalanced sales or promotional materials, whether prepared by the member, sponsor, or issuer.⁵

Internal Controls

Members must establish sufficient internal controls, including supervision and training requirements, that are reasonably designed to ensure that sales of NCI's comply with all applicable NASD and SEC rules. Members must ensure that their written procedures for supervisory and compliance personnel require that (1) the appropriate due diligence/reasonable-basis suitability is completed before products are offered for sale; (2) associated persons perform appropriate customer-specific suitability analysis; (3) all promotional materials are accurate and balanced; and (4) all NASD and SEC rules are followed. In addition to establishing written procedures, members also must document the steps they have taken to ensure adherence to these procedures.

Training

Members must train registered persons about the characteristics, risks, and rewards of each product before they allow registered persons to sell that product to investors. Likewise, members should train registered persons about the factors that would make such products either suitable or unsuitable for certain investors. Members' focus on training should not be limited to representatives selling such products; members also should provide appropriate training to supervisors of registered persons selling NCI's.

For a variety of reasons, the need for adequate training is heightened when registered persons sell NCI's. First, due to the unique nature of these products, many investors, especially retail investors, may not understand the features of the product, and may not fully appreciate the associated risks of investing in them. Moreover, in light of the fact that investors may be turning to these products as an alternative to traditional equity and fixed income investments, it is crucial for registered persons to provide a full and balanced disclosure regarding both the risks and the rewards of these products.

Educational brochures, videos, lectures, explanatory memoranda, and Web-based seminars are all appropriate ways of delivering training. The particular training methods will vary based upon the products themselves, as well as the size and customer base of the firm. NASD encourages firms that offer NCI's to offer training about these products as part of the Firm Element of their Continuing Education Program.

Conclusion

NClS can be unusual and complex investment vehicles that may appear increasingly attractive to investors during periods in which traditional equity and fixed income investments come into disfavor. However, the unique and complex features of some NClS may be difficult to understand and may obscure the risks. Accordingly, members must conduct appropriate due diligence/reasonable-basis suitability before offering any product to the public. Likewise, members must conduct a customer-specific suitability analysis prior to making any recommendations to a customer. Members also must ensure that all promotional materials are fair, accurate, and balanced. Finally, in connection with the recommendation and sale of NClS, members must ensure that they implement appropriate supervisory internal control and appropriate training to all registered persons who sell such products to customers.

Endnotes

- 1 Approximately 35% of the firms reviewed sold NClS in denominations that raise the possibility of sales to retail investors. The list of NClS being offered is broad and includes asset-backed securities, index-linked notes, non-traded REITS, equity-linked notes, multi-callable step up notes, redeemable secured notes, auction rate preferred securities, principal protected index-linked CDs, distressed debt, derivative products, and emerging market debt securities.
- 2 Members also are reminded of the application of IM-2310-2(e) (Fair Dealing with Customers with Regard to Derivative Products or New Financial Products), which emphasizes members' obligations for fair dealing with customers when making recommendations or accepting orders for new financial products.
- 3 NASD's use of the term "due diligence" is not intended to equate the responsibilities of a member for its sales conduct obligations with the requirements of an underwriter under Section 11 of the Securities Act of 1933 and Securities Act Rule 176.
- 4 NASD Conduct Rule 2310(b).
- 5 See NASD Letter of Acceptance, Waiver and Consent, Altegris Invs., Inc., and Robert Amedeo, No. CAF030015 (April 15, 2003).

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Notice to Members

NOVEMBER 2003

SUGGESTED ROUTING

Corporate Financing
Legal & Compliance
Senior Management
Trading & Market Making

KEY TOPICS

IPO Allocations
IPO Pricing
Rule 2710
Rule 2712
Underwriting Compensation

REQUEST FOR COMMENT ACTION REQUESTED BY JANUARY 9, 2004

Proposed Rule Governing Allocations and Distributions of Shares in Initial Public Offerings (IPOs)

Request for Comment on Regulatory Approaches to Enhance IPO Pricing Transparency; **Comment Period Expires January 9, 2004**

Executive Summary

NASD is proposing additional amendments to proposed Rule 2712—IPO Allocations and Distributions. On September 15, 2003, NASD filed with the Securities and Exchange Commission (SEC) proposed Rule 2712 to prohibit certain abuses in the allocation and distribution of shares in IPOs.¹ The additional amendments would implement several recommendations of the NYSE/NASD IPO Advisory Committee (IPO Advisory Committee or Committee), which was established at the request of the SEC. On May 29, 2003, the IPO Advisory Committee issued a report with 20 recommendations for the self-regulatory organizations (SROs) and the SEC to enhance public confidence in the integrity of the IPO process.

The proposed amendments to proposed Rule 2712 would address the following recommendations of the NYSE/NASD IPO Advisory Committee for SRO rulemaking:

- ▶ Require the lead managing underwriter to disclose indications of interest and final allocations to the issuer's pricing committee;
- ▶ Prohibit acceptance of market orders to purchase IPO shares in the aftermarket for one trading day following an IPO;
- ▶ Impose procedures designed to ensure that reneged IPO allocations are not used to benefit favored clients of the underwriter;

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- ▶ Require that any lock-up that applies to shares owned by the issuer's officers and directors also applies to shares they purchase in "friends and family" programs; and
 - ▶ Impose new notification requirements when underwriters waive lock-ups.

The *Notice* also requests comment on various additional regulatory steps that might be adopted to promote transparency in IPO pricing. These possible approaches, which could be adopted as alternatives, include requiring underwriters to:

- ▶ Retain an independent broker/dealer to opine that the initial IPO price range at which the offering is marketed and the final offering price are reasonable and to require that the independent broker/dealer's opinion is disclosed in the prospectus; or
- ▶ Use an auction or other system to collect indications of interest to help establish the final IPO price; or
- ▶ Include a "valuation disclosure" section in the prospectus with information about how the managing underwriter and issuer arrived at the initial price range and final IPO price, such as the issuer's one-year projected earnings or P/E ratios and share price information of comparable companies.

Action Requested

NASD requests comment on the proposed amendments. Members wishing to comment must make a submission that is 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
- ▶ Submitting comments online at the NASD Web Site (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 by e-mail or in writing.

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

Questions/Further Information

As noted, written comment should be submitted to Barbara Z. Sweeney. Questions concerning this *Notice* should be directed to Thomas M. Selman, Senior Vice President, Corporate Financing/Investment Companies, NASD, at (240) 386-4623; Joseph E. Price, Vice President, Corporate Financing Department, NASD, at (240) 386-4623; or Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, NASD, at (202) 728-8104.

Discussion

On August 22, 2002, the SEC requested that NASD and the New York Stock Exchange (NYSE) convene a high-level group of business and academic leaders to review the IPO process, to recommend ways to address the problems evidenced during the hot market of the late-1990s and 2000, and to improve the underwriting process. The NYSE/NASD IPO Advisory Committee met frequently in 2002 and early 2003 and issued its final report, containing 20 recommendations, in May 2003.

1. Rulemaking to Implement IPO Committee Proposals

NASD published *Notice to Members 02-55* in August 2002, requesting comment on proposed Rule 2712, which addressed allocation abuses. In September 2003, NASD filed with the Commission proposed Rule 2712 with modifications to the original proposal to reflect IPO Advisory Committee comments.² The amendments proposed today would supplement proposed Rule 2712 by addressing the IPO Advisory Committee recommendations described below:

a. Disclosure of Indications of Interest and Final Allocations

The IPO Advisory Committee recommended that issuers establish a pricing committee to evaluate the proposed offering price, and that underwriters be required to disclose to the issuer's pricing committee all indications of interest received before the issuer finalizes the IPO price. The Committee also recommended that underwriters be required to disclose to the issuer the final allocations after the offering is priced.

The Committee concluded that greater participation by issuers in pricing and allocation decisions would better ensure that those decisions are consistent with the fiduciary duty of directors and management, and would provide management with more information to evaluate the underwriter's performance. A requirement that issuers establish a pricing committee would necessitate a listing standard by The Nasdaq Stock Market and the NYSE.

NASD's proposed rule would require that the book-running manager(s) disclose indications of interest to a pricing committee, or to the issuer's board of directors if the issuer has no pricing committee, and that the book-running manager(s) disclose to the issuer final allocations made by the manager(s).

NASD requests comment on whether disclosure of other information to issuers also would be useful. For example, should issuers receive other specified information about the managing underwriters' pricing analysis or allocation decisions?

b. Trading Restrictions

The IPO Advisory Committee recommended a prohibition on market orders for one trading day following an IPO. The Committee concluded that, in light of the volatility of IPO issues, investors who place market orders immediately following an IPO may inadvertently purchase at prices that neither reflect their true investment decisions nor their reasonable expectations. By disallowing market orders for the first trading day following an IPO, the Committee reasoned that the market will have time to develop trading information, thereby making subsequent uncapped orders less likely to cause harm to retail investors. The proposed rule would prohibit any member from accepting a market order to purchase IPO shares during the first trading day that the IPO shares commence trading in the secondary market. Investors would remain free to place limit orders during this time period.

The IPO Advisory Committee also offered a recommendation concerning IPO shares that are returned to the underwriter after completion of distribution. The Committee noted that currently, if an IPO's shares trade at an immediate aftermarket premium, underwriters can allocate returned shares to favored customers at the IPO price, providing what may be a risk-free investment to those customers. In order to eliminate the possibility that this practice will occur, the proposed rule would require underwriters to allot returned shares to the existing syndicate short position, then sell the remaining returned shares on the open market and return net profits to the issuer. When the market price does not rise above the offering price, the underwriter should be permitted to sell the shares for its account or retain the shares by placing them in its investment account.

c. Limitations on “Friends and Family” Programs

The IPO Advisory Committee offered several recommendations concerning issuer-directed allocations of IPO shares. Among those recommendations, the Committee recommended requiring that any lock-up that applies to shares owned by officers and directors include the shares purchased by those individuals in the “friends and family” program. The proposed rule would require that any lock-up or restriction on the transfer of the issuer’s shares apply to issuer-directed shares held by officers and directors of the issuer.

d. Requirements Concerning Lock-up Exemptions

The IPO Advisory Committee concluded that investors reasonably expect that the issuer’s directors, officers, and large pre-IPO shareholders who agree to “lock up” their shares will be bound by those agreements for the stated period. The Committee therefore recommended that:

- ▶ Prior to granting any exemption to a lock-up, underwriters be required to notify the issuer and the issuer should be required to file a Form 8-K with the SEC concerning the exemption; and
- ▶ Prior to the transaction, the lead underwriter announce the exemption through a major news service.

The proposed rule would require an underwriter to notify the issuer prior to granting a lock-up exemption and to announce the exemption through a national news service. The requirement that issuers file a Form 8-K would require SEC rulemaking.

e. Other IPO Committee Recommendations

The IPO Advisory Committee offered other recommendations that will not necessitate rulemaking. In particular, the Committee recommended additional requirements for enhanced periodic internal review by underwriters of their IPO supervisory procedures and a heightened focus on the IPO process by the SROs. The Committee also recommended an educational program for new issuers and IPO investors. NASD intends to take action on these recommendations through our examinations and educational programs.

2. Rulemaking Concerning the Pricing of Unseasoned Issuers

Most of the IPO Advisory Committee's recommendations addressed the manner in which IPO shares are allocated, rather than the method by which they are priced. However, the IPO Advisory Committee did examine the pricing issue in two key respects:

- ▶ First, the IPO Advisory Committee recommended that regulators review existing rules and practices in order to promote the development of alternatives to the bookbuilding process. In particular, the Committee was interested in whether regulators could take any steps to foster development of the "Dutch Auction" system of price discovery.
- ▶ Second, the IPO Advisory Committee considered, but did not propose, a requirement that a prospectus provide an estimate of projected earnings in certain cases. Investment banks often provide projected earnings information to institutional investors, and this information is viewed as critical to the determination by institutional investors of whether IPO shares are fairly priced.

NASD requests comment on potential regulatory initiatives that would address the issue of fair and reasonable pricing of IPOs. After analyzing the comments received, we will determine whether to propose any new rules in this area.

Many IPO issuers in the late 1990s and 2000 had little or no revenues and subsequently experienced a dramatic run-up and decline in their stock price. Some critics have taken the position that the run-up demonstrates that these IPOs were underpriced; others have countered that the subsequent significant drop in the price of these securities, at times well below the IPO price, demonstrates that the offerings were actually overpriced. This debate suggests that some action may be appropriate to shed further light on IPO pricing.

Three possible approaches might be to require the managing underwriter to:

- ▶ Retain an independent broker/dealer to opine that the initial IPO price range at which the offering is marketed and the final offering price are reasonable and to require that the independent broker/dealer's opinion is disclosed in the prospectus; or
- ▶ Use an auction or other system to collect indications of interest to help establish the final IPO price; or
- ▶ Include a "valuation disclosure" section in the prospectus with information about how the managing underwriter and issuer arrived at the initial price range and final IPO price, such as the issuer's one-year projected earnings or P/E ratios and share price information of comparable companies.

NASD requests comment on these potential approaches, including the relative merits of each. Commenters should be aware that these three approaches are listed as alternatives. NASD is requesting comment on these concepts both as stand-alone proposals and as alternatives. Which alternative or set of alternatives is most likely to benefit issuers and investors? What other alternatives, if any, might address the pricing issue?

Should the reforms be adopted for the IPOs of all issuers or only for IPOs of “unseasoned” issuers? If the latter, how should seasoning be measured—for example, by three years of revenues, operating revenues, or net income? Would the reforms provide greater assurance that either unseasoned issuers are properly priced or that the methods by which their shares are valued are adequately disclosed?

Finally, NASD asks commenters to address the additional risk placed on the issuer and underwriters by the independent pricing opinion and valuation disclosure proposals. Before requiring issuers and underwriters to assume additional liability risk by including this information in IPO prospectuses, would it be appropriate or necessary for the SEC to consider rulemaking to provide issuers and underwriters with a safe harbor from liability? Today, Rule 175 under the Securities Act of 1933 provides a safe harbor, but only for projections that have a “reasonable basis” and are “made in good faith.” We have been informed that most issuers do not provide earnings projections under Rule 175 because of the litigation risk that is associated with these limitations. Section 27A of the Securities Act authorizes the SEC to provide a safe harbor that requires actual knowledge that a forward-looking statement is false before it becomes actionable. Currently, however, Section 27A does not apply to IPOs. Should the Section 27A safe harbor be expanded to IPOs if the independent pricing opinion or valuation disclosure reforms were required under NASD rules?

Endnotes

- 1 File No. SR-NASD-2003-140 (Sept. 15, 2003).
- 2 As proposed in *Notice to Members 02-55*, Rule 2712 addressed “quid pro quo” allocations, “spinning,” “laddering,” and inequitable penalty bids. The amended proposal filed in September 2003 did not include the laddering provision, and the prohibition on spinning was modified to reflect the IPO Advisory Committee’s recommendation that NASD bar IPO allocations to all executive officers and directors of a company with which a member has an investment banking relationship—not just allocations that constitute a quid pro quo for investment banking business.

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Rule 2712. Allocation and Pricing of Initial Public Offerings.

* * *

(a) – (d) No changes from File No. SR-NASD-2003-140 (Sept. 15, 2003)

(e) IPO Pricing

No member may serve as the book-running lead manager of an initial public offering of equity securities (“IPO”) unless the IPO meets all of the following conditions:

(1) *Underwriting Agreement.* The agreement between the book-running lead manager and the issuer provides that:

(A) the book-running lead manager will provide the issuer’s pricing committee (or, if the issuer has no pricing committee, its board of directors):

(i) a regular report of indications of interest, including the names of interested investors and the number of shares indicated by each;

(ii) after the closing date of the IPO, a report of the final allocation of shares available to the manager, including the names of purchasers and the number of shares purchased by each;

(B) any lock-up or other restriction on the transfer of the issuer’s shares by officers and directors of the issuer will apply to their issuer-directed shares;

(C) at least two business days before the release or waiver of any lock-up or other restriction on the transfer of the issuer’s shares, the book- running lead manager will notify the issuer of the impending release or waiver and announce the impending release or waiver through a national news service;

(2) *Agreement Among Underwriters.* The agreement between the book-running lead manager and other syndicate members provides that with respect to any shares returned by a purchaser to a syndicate member after secondary market trading commences:

(A) the returned shares will be allotted to the existing short position of the syndicate;

(B) if no short position exists, or if all existing syndicate short positions have been covered, the returned shares will be sold on a national securities exchange or Nasdaq;

(C) in the event of any sales under paragraph (B), if the sales price exceeded the IPO price, the difference will be paid to the issuer;

(D) if the market price is less than the IPO price, then the syndicate member may either sell the shares under paragraph (B) or retain them in its own investment account.

(3) No member may accept a market order for the purchase of IPO shares during the first day that IPO shares commence trading on the secondary market.

Notice to Members

NOVEMBER 2003

SUGGESTED ROUTING

Legal & Compliance
Registered Representative
Senior Management

KEY TOPICS

Notices to Members
Public Access to Comments
Requests for Comment

INFORMATIONAL

Online Comments

NASD Announces Online Availability of Comments

Executive Summary

NASD today announced that it is now making available on its Web Site comments filed in response to *Notices to Members* that include a request for comments on rule proposals or regulatory initiatives. Posting comments online will make it easier for the public to access and review the submissions, and will improve the efficiency with which NASD maintains, reviews, and makes available the comments it receives.

As in the past, comments may be submitted either in writing to Barbara Z. Sweeney, Senior Vice President and Corporate Secretary of NASD, or electronically to pubcom@nasd.com. On occasion, NASD may also provide commenters with an online form for this purpose.

Questions/Further Information

Questions regarding this *Notice to Members* may be directed to Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, at (202) 728-8062 or Barbara.Sweeney@nasd.com.

Discussion

Comments received in response to a request for comments on rule proposals or regulatory initiatives via the *Notice to Members* process have always been available to the public to ensure that all interested parties have the opportunity to review them. In the past, comments were obtained by interested parties calling or writing NASD to request this material. Now, by posting all comments online, whether received by NASD in hard copy or electronically, the public will have easier access to review these submissions.

Online availability of comments is consistent with the practice of the Securities and Exchange Commission (SEC) and other regulatory agencies. Like the SEC, NASD will post comments on its Web Site as submitted by the author(s). Therefore, parties should submit in their comments only information that they wish to make available publicly. Any individual or organization planning to submit comments to NASD should be aware that those comments, whether submitted electronically or via hard copy, will be made available online and in hard copy. The following notice will appear on NASD's Web Site concerning comments posted electronically: *The views, expressions, findings, and opinions expressed in the comments on this Web page are solely those of the author(s) and NASD accepts no responsibility for the content of the comments.*

Background

Before adopting a new rule that would govern the conduct of NASD member firms, NASD is required to file the proposed rule with the SEC, which then publishes the rule in the *Federal Register* so that the public may consider it. In general, interested persons have at least 21 days from the date of publication to register their comments. After those comments are received, the SEC may approve or disapprove the rule, or NASD may decide to change it.

Prior to filing a rule change with the SEC, NASD generally solicits comments on the proposal from its members, investors, and the general public through a *Notice to Members*, which is posted on NASD's Web Site. At times, NASD also may solicit comment through a *Notice to Members* on alternative approaches to a particular issue, similar to the issuance of a "concept release" by the SEC. The *Notice to Members* describes the rule proposal or area of regulatory interest and indicates when and how comments may be submitted. Generally, members and interested parties may submit their comments via one of the following methods:

- ◆ Mailing in written comments to Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, 1735 K Street, NW, Washington, DC 20006-1500
- ◆ E-mailing written comments to pubcom@nasd.com
- ◆ Submitting comments online at the NASD Web Site (www.nasd.com)

Comments received during the comment period from members, investors, and the general public are fully considered before any further action is taken by NASD.

Procedure for Viewing Comments Online

Interested parties will be able to access comments on NASD's Web Site by accessing the appropriate *Notice to Members* and through a special page that will list all *Notices to Members* that have requested comments. Generally, comments will be posted on the NASD Web Site one week after the end of a comment period.

Members may continue to request a hard copy of the comments that NASD receives by sending a letter to:

Barbara Z. Sweeney
Senior Vice President and Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1500

Effective Date

Comments will be posted online for all *Notices to Members* issued on or after December 1, 2003, that seek comment on a proposal.

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Notice to Members

NOVEMBER 2003

SUGGESTED ROUTING

Internal Audit
Legal & Compliance
Operations
Senior Management
Trading And Market Making

KEY TOPICS

Limit Order Protection
Market Making
Multiple MPIDs

INFORMATIONAL

Limit Order Protection

Guidance Relating to the Application of NASD's Limit Order Protection Rule When Trading Proprietarily Through a Separate MPID

Executive Summary

Recently The Nasdaq Stock Market, Inc. (NASDAQ) began permitting market makers and ECNs to request the use of a second Market Participant Identifier (MPID) in the NASDAQ quotation montage for the entry of quotes and orders and the display of quotations. Because members now may enter and display quotes and orders from other desks in a separate MPID, members have sought clarification concerning the applicability of previous guidance relating to Interpretive Material 2110-2, Trading Ahead of Customer Limit Order (commonly referred to as the "Manning Rule") provided in *Special Notice to Members (NtM) 95-43* (June 5, 1995). Specifically, *NtM 95-43* provided a "no knowledge" interpretation to the Manning Rule such that, if a firm implements and utilizes an effective system of internal controls, such as appropriate information barriers, that operate to prevent a non-market-making desk from obtaining knowledge of customer limit orders held at the firm's market-making desk, those other desks trading in a proprietary capacity may continue to trade at prices the same as or inferior to the customer limit orders held by the market-making desk. As described in more detail in this *Notice*, members using multiple MPIDs may continue to rely on the "no knowledge" interpretation to Manning contained in *NtM 95-43* if they have established appropriate and effective information barriers between market-making desks and other trading desks exclusively engaged in proprietary trading.

Questions/Further Information

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation, NASD, at (240) 386-5126; or the Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-8071.

Background

The Manning Rule generally prohibits market makers from trading for their own account at prices that would satisfy a customer's limit order in NASDAQ and listed securities, unless the market maker immediately thereafter executes the customer limit order.¹ The legal underpinnings for the Manning Rule are the members' basic fiduciary obligations and the requirement that they must, in the conduct of their business, "observe high standards of commercial honor and just and equitable principles of trade."² The Manning Rule codified an NASD disciplinary decision, which was affirmed by the SEC, that it was inconsistent with the member's fiduciary duty to compete with the customer with respect to the subject matter of their relationship: the execution of the customer's order. While the rule is written specifically to cover trading by market makers in their market-making capacity, NASD's long-held position is that a member's best-execution duty imposes the Manning obligation on all members, whether or not they are trading in a market-making capacity.³ Based on this interpretation, members sought guidance as to how Manning should be applied to a firm that has a market-making desk and several other non-market-making desks (e.g., an arbitrage desk) that trade NASDAQ securities exclusively on a proprietary basis.

At issue was the question of whether proprietary transactions by these other desks would "trigger" the Manning obligation and require the firm to fill the customer limit orders held by the market-making desk. *NtM 95-43* stated that it would be inconsistent with a member's best execution obligation for these other desks knowingly to trade ahead of a customer's limit order. However, NASD clarified its position on this issue in *NtM 95-43* by establishing a "no knowledge" interpretation relating to whether trades by non-market-making desks trigger Manning. Specifically, the *Notice* stated that "[a]s long as a firm implements and utilizes an effective system of internal controls, such as appropriate 'Chinese walls,' that operate to prevent the non-market-making desk from obtaining knowledge of customers' limit orders, those other desks may continue to trade at prices the same as or inferior to the customers' limit orders."⁴

Recently, members have sought clarification concerning the applicability of the Manning Rule and *NtM 95-43*'s "no knowledge" interpretation in the context of using an additional unattributable MPID (hidden behind the SIZE MPID) or an additional displayed MPID (displayed in the quotation montage) to represent proprietary trading interest from a non-market-making desk. Specifically, members have inquired whether proprietary trades executed by a non-market-making desk through the use of such unattributable or attributable additional MPIDs would result in a Manning obligation to customer limit orders held by the market-making desk.

In response, NASD staff is clarifying that, as stated in *NtM 95-43*, if the firm implements and utilizes an effective system of internal controls, such as appropriate information barriers, that operate to prevent non-market-making desks engaged exclusively in proprietary trading from obtaining knowledge of customer limit orders held at the market-making desk, those other proprietary non-market-making desks may continue to trade in a principal capacity at prices the same as or inferior to the customer limit orders held at the market-making desk. An effective system of internal controls must include specific policies and procedures that prevent each of the desks separated by information barriers from obtaining knowledge regarding orders or trading activity of the other desks. For example, if a trader or other person associated with a market-making desk, having observed the quotation activity of an affiliated non-market-making desk via a second MPID, attempted to contact that desk to obtain any information about the non-market-making desk's past, current, or future trading plans, such conduct would be inconsistent with the establishment of an effective system of internal controls and therefore would trigger Manning obligations for the market-making desk based on trading activity by the non-market-making desk. Conversely, knowledge of a quotation displayed by another proprietary desk using a separate MPID or a presumption based on publicly available information that the other proprietary desk may have executed a trade (e.g., a transaction accompanied by a quote decrementation), would not, in and of itself, trigger Manning obligations, if an effective system of internal controls between these desks had been established.

Members are reminded that NASD will continue to examine and review members using information barriers for compliance with this and other applicable information barrier standards. In addition, NASD Rule 3010 requires that members establish and maintain a supervisory system that is designed to ensure compliance with the NASD rules. Accordingly, NASD will examine closely members' supervisory systems and written supervisory procedures and, where appropriate, initiate disciplinary action against firms and their supervisory personnel for failure to adopt, implement, and enforce appropriate supervisory procedures. NASD also will impose significant sanctions if it finds that members have intentionally compromised their information barriers to the detriment of customer orders.

Endnotes

- 1 For example, if the market maker bought 100 shares at \$10 when holding customer limit orders to buy at \$10 equaling, in aggregate, 1000 shares, the market maker is required to fill 100 shares of the customer limit orders.
- 2 See NASD Rule 2110.
- 3 See *NtM 95-43* at p. 309.
- 4 *Id.*

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Disciplinary and Other NASD Actions

REPORTED FOR NOVEMBER

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of October 2003.

Firms Fined, Individuals Sanctioned

Axiom Capital Management, Inc. (CRD #26580, New York, New York), Mark David Martino (CRD #1010228, Registered Principal, White Plains, New York), David Leon Jordon (CRD #262161, Registered Representative, Scarsdale, New York), and Jeffrey Stuart Goldberg (CRD #1947322, Registered Representative, Hillside, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$50,000. Martino was fined \$15,000 and suspended from association with any NASD member in any principal or supervisory capacity for 60 days. Jordon was fined \$10,000 and suspended from association with any NASD member in any capacity for 20 days. Goldberg was fined \$10,000 and suspended from association with any NASD member in any capacity for 45 days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, Jordon, and Goldberg published and disseminated to the investing public research reports regarding issuers that contained material misrepresentations, omissions of fact, and exaggerated, unwarranted, and misleading statements. The findings also stated that the firm failed to disclose its ownership of warrants.

NASD also found that the firm and Martino failed to insure that each item of sales literature, including research reports, was approved by signature or initial by a registered principal. Although Martino approved each report for publication, he failed to do so by signature or initial as required. In addition, NASD found that the firm and Goldberg disclosed in a report that the firm had received fees for writing research reports but failed to disclose the amount as required by the Securities Act of 1933. Moreover, NASD found that the firm and Martino failed to adequately supervise Jordon and Goldberg in their writing of research reports. Furthermore, NASD found that the firm failed to establish, maintain, and enforce a system and written supervisory procedures to supervise the publication of research reports reasonably designed to achieve compliance with rules and regulations.

Goldberg's suspension began October 20, 2003, and will conclude at the close of business December 3, 2003. Jordon's suspension began October 20, 2003, and concluded November 8, 2003. Martino's suspension began October 20, 2003, and will conclude at the close of business December 18, 2003. (NASD Case #CAF030047)

Harrison Douglas, Inc. (CRD #16515, Denver, Colorado) and Douglas Wayne Schriener (CRD #1140409, Registered Principal, Aurora, Colorado) submitted an Offer of Settlement in which the firm was censured and fined \$25,000, jointly and severally with Schriener. Schriener was also 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 Schriener failed to disclose timely material facts on his Uniform Application for Securities Registration or Transfer (Form U4). The findings also stated that Schriener filed false and misleading information on his Form U4 and did not complete the Regulatory Element of Continuing Education for which his registration subsequently became inactive and continued to act in capacities that required registration. NASD also found that the firm, acting through Schriener, failed to take steps to prohibit Schriener from performing any duties and functioning in any capacity requiring registration. The findings also stated that the firm's supervisory procedures were not reasonably designed to achieve compliance with NASD Membership and Registration Rule 1120(a), the Regulatory Element of Continuing Education.

Schriener's suspension began October 20, 2003, and will conclude at the close of business November 18, 2003. (NASD Case #C3A030028)

Kelmoore Investment Co., Inc. (CRD #22509, Palo Alto, California) and Shawn Kelmon Young (CRD #4089904, Registered Principal, Palo Alto, California). The firm was censured and fined \$10,000, and Young was fined \$10,000 and suspended from association with any NASD member as a financial and operations principal for 30 business days. The sanctions were based on findings that the firm, acting through Young, utilized the instrumentalities of interstate commerce to engage in securities transactions while failing to maintain its minimum net capital as required by the Securities and Exchange Commission (SEC). NASD also found that the firm, acting through Young, entered on its books and records a journal entry totaling \$200,000 for which there was no basis.

Young's suspension began September 15, 2003, and concluded at the close of business October 24, 2003. (NASD Case #C01020012)

Paragon Capital Markets, Inc. (CRD #18555, East Hanover, New Jersey), George Bernard Levine (CRD #307904, Registered Principal, Boca Raton, Florida), and Danny Jay Levine (CRD #1007419, Registered Principal, East Hanover, New Jersey) submitted an Offer of Settlement in which the firm was censured and fined \$50,000, jointly and severally with G. Levine and D. Levine. The firm agreed to refrain from participating as a lead underwriter or co-underwriter in an initial public offering (IPO) of securities for three years. The firm also agreed to refrain from maintaining and servicing more than 100 retail securities accounts for three years and not to replace any

of the 100 retail securities accounts with new accounts should any of them be closed by public customers during the three-year period. George Levine was also fined \$25,000, suspended from association with any NASD member in any capacity for 60 days, and ordered to requalify by exam as a general securities principal (Series 24) before serving in a capacity requiring such registration. Danny Levine was also fined \$40,000, suspended from association with any NASD member in any capacity for 60 days, and ordered to requalify by exam as a general securities principal (Series 24) before serving in a capacity requiring such registration.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through G. Levine, engaged in the sale of IPO common shares and warrants to public customers, misrepresented the structure of the IPO, and created an improper tie-in by instructing the firm's brokers to solicit the offering securities to customers as a unit only when the firm's Registration Statement filed with the SEC provided that common shares and warrants could be purchased separately. The findings also stated that the firm, acting through G. Levine, engaged in unauthorized trades by causing purchases of the offering to be inputted upon the effective time of the offering without giving the brokers the required opportunity to first call the customers to firm up the IPO purchases. NASD also found that the firm, acting through G. Levine, caused the clearing firm to create and mail inaccurate transaction confirmations to customers that failed to disclose the actual number of IPO shares and warrants purchased and reflected an unauthorized purchase of a unit IPO security.

In addition, NASD found that the firm, acting through G. Levine, caused the firm to maintain inaccurate books and records by entering a dummy "ADP" security number for a non-existent unit security on confirmations, trade cancellation notices, client account statements, and proprietary account statements, and by recording the entry of sales and cancellations of such sales for nonpayment when no such legitimate sales had ever occurred. Moreover, the firm, acting through D. Levine, placed IPO securities in customer accounts to give the false impression that the offering securities were fully distributed when, in fact, they were not. Furthermore, NASD found that the firm, acting through D. Levine, failed to timely cancel the unauthorized IPO purchases and delayed taking the securities back into the firm's inventory at the IPO price that was at that time higher than the market price, avoiding significant losses. The findings also stated that the firm, acting through D. Levine, created a market in IPO securities before completing a bona fide distribution of the IPO securities to the public.

Danny Levine's suspension began November 3, 2003, and will conclude January 1, 2004. George Levine's suspension will begin January 5, 2004, and will conclude at the close of business March 5, 2004. (NASD Case #CAF030009)

Summit Trading, Inc. (CRD #43160, Coral Springs, Florida) and William Neal Sunshine (CRD #1739205, Registered Principal, Houston, Texas) submitted an Offer of Settlement in which the firm was censured and fined \$17,500, \$7,500 of which was assessed jointly and severally with Sunshine. Additionally, Sunshine was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Sunshine reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Sunshine, engaged in a securities business while failing to maintain sufficient net capital. The findings also stated that the firm, acting through Sunshine, failed to maintain and keep current its general ledger and trial balance and the firm failed to file its FOCUS Part IIA report. The findings further stated that the firm, acting through Sunshine, failed to establish, maintain, and enforce a system reasonably designed to ensure the firm's compliance with all aspects of the Net Capital Rule. NASD found that the firm failed to indicate on the order memorandum for short-sale transactions whether the order was long or short and failed to include the short-sale modifier for transaction reports transmitted through the Automated Confirmation Transaction ServiceSM (ACTSM). In addition, the findings stated that the firm effected short sales for Nasdaq National Market[®] (NNM[®]) securities at or below the inside bid when the current inside bid was below the preceding inside bid.

Sunshine's suspension began November 3, 2003, and will conclude May 2, 2004. (NASD Case #C06030015)

Tejas Securities Group, Inc. (CRD #36705, Austin, Texas) and Arnold Reed Durant (CRD #716150, Registered Principal, Austin, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$35,000, \$10,000 of which was jointly and severally with Durant. The firm was also required to file with NASD's Advertising Regulation Department the firm's current Web site and all revisions to the Web site, including all sales literature and advertisements posted on the Web site at least 10 days prior to their first use for six months. Durant was also censured and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, the firm and Durant consented to the described sanctions and to the entry of findings that the firm's Web site contained research coverage of various stocks that contained exaggerated, unwarranted, or misleading statements and claims. The findings also stated that the firm's Web site selectively posted successful recommendations and failed to set forth all recommendations as to the same type, kind, grade, or classification of securities made by the firm within the prior year. NASD also found that the firm posted press releases and summaries of research reports for issuers on the Web site that failed to present a complete

discussion of the risks associated with the securities discussed and contained a high price target without fully disclosing the basis for such larger price or the speculative nature of the security. In addition, NASD found that the firm failed to adequately keep and maintain complete records or files relating to the preparation and approval of the press releases and summaries of the research reports and the dates when they were posted on the Web site. Moreover, NASD found that Durant failed to adequately supervise the posting of press releases and research report summaries on the firm's Web site and failed to review, or adequately review, some of the other materials posted on the Web site.

Durant's suspension began October 20, 2003, and concluded at the close of business October 24, 2003. (NASD Case #CAF030051)

Firms and Individuals Fined

D.R. Mayo & Co., Inc. (CRD #8658, San Francisco, California) and Donald Richard Mayo (CRD #324176, Registered Principal, Moraga, California) submitted an Offer of Settlement in which they were censured and fined \$17,500, 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, acting through Mayo, permitted representatives to perform duties as registered persons when they were deemed inactive for failure to comply with the Regulatory Element of Continuing Education. The findings stated that the firm, acting through Mayo, failed to establish and maintain a supervisory system or failed to establish, maintain, and enforce written procedures reasonably designed to achieve compliance with federal securities laws and NASD rules. The findings also stated that the firm, acting through Mayo, failed to report promptly to NASD customer complaints against the firm and Mayo that were settled for more than \$15,000. The findings further stated that the firm, acting through Mayo, utilized the instrumentalities of interstate commerce to engage in securities business while failing to maintain the required minimum net capital. NASD also found that the firm, acting through Mayo, failed to prepare and maintain monthly net capital computations. (NASD Case #C01030005)

O'Brien & Shepard, Inc. (CRD #7152, Englewood Cliffs, New Jersey), Jeffrey Peter Flaster (CRD #209507, Registered Principal, Fort Lee, New Jersey), and Michael Stuart Petrucelli (CRD #1106857, Registered Principal, Short Hills, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$20,000, 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, acting through Flaster, permitted a representative to act as a municipal securities representative

prior to properly qualifying and/or registering as such. NASD also found that the firm, acting through Petrucelli, permitted registered representatives to act in a capacity that required registration while their registration statuses with NASD were inactive due to their failure to complete the Regulatory Element of NASD's and the Municipal Securities Rulemaking Board's (MSRB) Continuing Education Requirements. The findings also stated that the firm failed to establish and maintain adequate written supervisory procedures reasonably designed to achieve compliance with the Regulatory Element of NASD's and the MSRB's Continuing Education Requirements. **(NASD Case #C9B030065)**

Firms Fined

Banc One Securities Corporation (CRD #16999, Columbus, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it permitted individuals to perform duties as registered persons while their registration statuses were inactive due to failure to timely complete the Regulatory Element of NASD's Continuing Education Requirements. The findings also stated that the firm received written customer complaints and failed to file the complaints with NASD in a timely manner. NASD also found that the firm utilized confidentiality clauses in settlement agreements with public customers that prohibited or otherwise inhibited the customers from disclosing the settlement terms and underlying facts of the disputes to securities regulators and self-regulatory organizations (SROs). **(NASD Case #C8B030018)**

Burlington Capital Markets, Inc. (CRD #26991, 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 supervisory procedures concerning short-sale rules 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 executed short-sale orders in certain securities and failed to make an affirmative determination prior to executing such transactions. 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 rules. **(NASD Case #CMS030209)**

Citigroup Global Markets Inc. (CRD #7059, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$72,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it effected transactions in NNM Securities while a trading halt was in effect. 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, and failed to designate through ACT such last-sale reports as late. The findings stated that, as a registered market maker in securities, an order was presented to the firm at the firm's published bid or published offer in an amount up to its published quotation size. NASD found that the firm failed to execute the orders upon presentment and thereby failed to honor its published quotation. The findings also stated that the firm failed, in transactions for or with a customer, to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. Furthermore, NASD found that the firm failed to contemporaneously or partially execute customer limit orders in NASDAQ securities after it traded each subject security for its own market-making account at a price that would have satisfied each customer's limit order.

In addition, the findings 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 agency capacity. NASD also determined that the firm failed to display immediately customer limit orders in NASDAQ securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer in such security, and the size of the order represented more than a de minimis change in relation to the size associated with its bid or offer in each such security. The findings also included that the firm incorrectly reported through ACT duplicate last-sale reports of transactions in OTC Equity securities. **(NASD Case #CMS030211)**

EDI Financial, Inc. (CRD #15699, Dallas, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$12,500, and ordered to pay \$6,181, plus interest, in restitution to a public customer. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it sold municipal bonds from its own account to that of a customer at aggregate prices that were not fair and reasonable. The findings also stated that the firm failed to establish and maintain a supervisory system reasonably designed to ensure that the aggregate prices for municipal transactions were fair and reasonable. **(NASD Case #C06030022)**

GunnAllen Financial, Inc. (CRD #17609, Tampa, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000, \$5,000 of which was imposed jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm, acting through an individual, failed to obtain NASD approval prior to effecting a material change in business operations by expanding the number of registered representatives and branch offices beyond the limits delineated by NASD. **(NASD Case #C07030066)**

J.P. Turner and Company, L.L.C. (CRD #43177, Atlanta, Georgia) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000, \$7,500 of which was jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to obtain the information required by NASD from investment partnerships, corporations, or similar accounts prior to selling shares of hot issues to those accounts. The findings also stated that the firm accepted cash deposits from public customers for the purchase of hot issue IPOs prior to the effective date of the offerings. NASD also found that the firm filed inaccurate Free-Riding and Withholding Questionnaires that failed to disclose purchases by investment partnerships, corporations, or similar accounts. In addition, NASD found that the firm, acting through an individual, failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules relating to the sale of hot issues. (NASD Case #C07030068)

MONY Securities Corporation (CRD #4386, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$225,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to establish and maintain a system to supervise the activities of registered representatives relating to their participation in outside business activities and private securities transactions. The findings stated that the firm failed to effectively respond to warning signals that representatives were engaged in outside business activities and/or selling away. NASD also found that the firm failed to conduct a complete investigation of representatives' selling away activities and failed to take prompt and effective action to prevent representatives from continuing to sell away. In addition, NASD found that the firm failed to monitor incoming and outgoing correspondence as required and failed to promptly and effectively address deficiencies discovered during internal audits. Furthermore, the findings stated that the firm failed to report the selling away violations to NASD. (NASD Case #C02030057)

National Clearing Corp. (CRD #14343, Beverly Hills, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$70,000, required to pay \$8,171.43, plus interest, in restitution to public customers, and required to revise its written supervisory procedures with respect to applicable securities laws and regulations concerning the Order Audit Trail SystemSM (OATSSM), the Three-Quote Rule, best execution, ACT reporting, limit-order display, the 1% Rule, and short-sale affirmative determination 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 use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in

such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. The findings stated that the firm also incorrectly reported principal transactions with its customers as agency cross transactions and failed to display immediately customer limit orders in NASDAQ securities and listed securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer in such security, and the size of the order represented more than a de minimis change in relation to the size associated with its bid or offer in each such security. NASD determined that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning OATS, the Three-Quote Rule, best execution, ACT reporting, limit-order display, the 1% Rule, and short-sale affirmative determination. (NASD Case #CMS030214)

NexTrade, Inc. (CRD #41087, Clearwater, Florida) 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 transmitted to OATS order reports that contained inaccurate, incomplete, or improperly formatted data. Specifically, the findings stated that the order reports failed to match to an ACT trade report, omitted the MPID of the sending firm, failed to report the proper order type, and failed to note all terms and conditions. In addition, the findings stated that the firm failed to submit required information to OATS for an order. (NASD Case #CMS030219)

Performance Capital Group LLC (CRD #35032, 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 published quotations for an OTC equity security or, directly or indirectly, submitted such quotations for publication in a quotation medium and did not have in its records the documentation required by SEC Rule 15c2-11(a) ("Paragraph (a) information"); did not have a reasonable basis under the circumstances for believing that the Paragraph (a) information was accurate in all material respects; or did not have a reasonable basis under the circumstances for believing that the sources of the Paragraph (a) information were reliable. The findings stated that the firm failed to file a Form 211 with NASD at least three business days before the firm's quotations were published or displayed in a quotation medium. 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 SEC Rule 15c2-11 and NASD Marketplace Rule 6740. (NASD Case #CMS030207)

Prudential Securities Incorporated (CRD #7471, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was fined \$90,000, including disgorgement to NASD of \$22,677 in unlawful commissions received. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that the firm sold shares of unregistered stock and failed to investigate whether or not the stock could be legally sold despite being presented with numerous "red flags" indicating that a searching inquiry into the stock's registration was warranted. The findings also stated that the firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with federal securities laws, regulations, and NASD rules with respect to the sale of unregistered securities. **(NASD Case #CAF030048)**

Quest Capital Strategies, Inc. (CRD #16783, Laguna Hills, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$41,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it maintained NASD registrations of representatives who were not active in the firm's investment banking or securities business or were not functioning as representatives. The findings stated that the firm allowed registered individuals to perform duties requiring registration while the status of their registrations was inactive because they failed to complete the Regulatory Element of NASD's Continuing Education Rule. NASD also found that the firm, acting through an employee, failed to establish and maintain a system to supervise the activities of registered representatives reasonably designed to achieve compliance with NASD rules. **(NASD Case #C02030058)**

Ramius Securities, LLC (CRD #41076, 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 the entry of quotations into a quotations medium. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it published quotations for an OTC equity security or, directly or indirectly, submitted such quotations for publication in a quotation medium and did not have in its records the documentation required by SEC Rule 15c2-11(a) ("Paragraph (a) information"); did not have a reasonable basis under the circumstances for believing that the Paragraph (a) information was accurate in all material respects; or did not have a reasonable basis under the circumstances for believing that the sources of the Paragraph (a) information were reliable. The findings stated that the firm failed to file a Form 211 with NASD at least three business days before the firm's quotations were published or displayed in a quotation

medium. 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 entry of quotations into a quotations medium. **(NASD Case #CMS030208)**

Service Asset Management Company (CRD #47157, Austin, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000, \$5,000 of which was assessed jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it conducted a securities business while failing to maintain its required minimum net capital. The findings also stated that the firm failed to properly identify trades reported to ACT as "sell short" and/or "sell short exempt." **(NASD Case #C06030021)**

The Island ECN, Inc. (CRD #20746, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. 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 and execution reports and to report Reportable Order Events (ROEs) to OATS. NASD also found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning OATS reporting. **(NASD Case #CMS030218)**

Track Data Securities Corporation (CRD #103802, Brooklyn, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$30,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to submit required information to OATS on 129 business days. **(NASD Case #CMS030221)**

Individuals Barred or Suspended

Anthony Harold Barkate (CRD #1255255, Registered Principal, Bakersfield, California) was barred from association with any NASD member in any capacity. The National Adjudicatory Council (NAC) imposed the sanction following appeal of an Office of Hearing Officers (OHO) decision. The sanction was based on findings that Barkate participated in private securities transactions without giving prior written notice to his member firm.

This case has been appealed to the SEC, and the bar is in effect pending consideration of the appeal. **(NASD Case #C02010041)**

David Mylo Beam (CRD #856560, Registered Representative, Seattle, Washington) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Beam consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transactions in a public customer's account on a discretionary basis without obtaining prior written authorization from the customer or his member firm.

Beam's suspension began November 3, 2003, and concluded at the close of business November 14, 2003. (NASD Case #C3B030016)

Samuel Bjelac, III (CRD #2973220, Registered Representative, Curtis Bay, Maryland) 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 Bjelac reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Bjelac consented to the described sanctions and to the entry of findings that he recommended and effected securities transactions without having reasonable grounds to believe that his recommendations to a public customer were suitable for the customer based on the customer's financial situation and needs, and in the light of the speculative nature of the trading strategies employed.

Bjelac's suspension began October 20, 2003, and will conclude at the close of business October 19, 2004. (NASD CASE #C9A030034)

Linda Cindy Brown (CRD #3008197, Associated Person, Strafford, Pennsylvania) submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$2,500 and suspended from association with any NASD member in any capacity for one month. The fine must be paid before Brown reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Brown consented to the described sanctions and to the entry of findings that she willfully failed to amend her Form U4 to disclose a material fact.

Brown's suspension began October 6, 2003, and concluded at the close of business November 5, 2003. (NASD Case #C9A030031)

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 deposit into the customers' brokerage accounts and, without the customers' knowledge or consent, converted the funds by making internal accounting entries on the books and records of his member firm, caused the checks to be deposited in his personal brokerage account at his member firm, and used the funds for his own use and benefit. NASD also found that Buckingham failed to respond to NASD requests for information. (NASD Case #C04030006)

Jeffrey Robert Casciano (CRD #1598962, Registered Representative, Hoboken, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for 31 days; Casciano is deemed to have paid the \$15,000 fine and served the 31-day suspension. Without admitting or denying the allegations, Casciano consented to the described sanctions and to the entry of findings that he entered priced limit orders in NASDAQ securities through a member firm's terminals. NASD found that these orders were intended to improve, and did in fact improve, the National Best Bid or Offer (NBBO) in the applicable securities. The findings stated that, after having entered such orders, Casciano entered larger orders on the other side of the market to buy or sell shares of such securities for a firm proprietary account or a firm customer account. NASD found that, as intended, the orders were 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. In addition, NASD determined that, as a result, orders to buy shares of these securities were executed at prices that were lower, and orders to sell shares were executed at prices that were higher, than otherwise would have been available, but for the entry of the NBBO improving orders; and, within a short time after execution of the orders, Casciano canceled priced limit orders that had been placed. Furthermore, NASD found that Casciano bought and sold these NASDAQ securities and generated profits. (NASD Case #CMS030206)

Sergio Castro (CRD #1865355, Registered Principal, Fullerton, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Castro consented to the described sanction and to the entry of findings that, without the prior knowledge, authorization, or consent from public customers, he executed and/or caused to be executed unauthorized transactions totaling \$1,000,000 in the customers' account and received \$20,000 in commissions. The findings also stated that Castro failed to respond to NASD requests for information. (NASD Case #C02030055)

Carl Edward Cherasia (CRD #2839143, Registered Representative, Toms River, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Cherasia consented to the described sanction and to the entry of findings that he sent a public customer a "Position Report" that misrepresented the value of the holdings in his brokerage account. NASD also found that Cherasia failed to respond to NASD requests for information. (NASD Case #C9B030071)

Brian James Clark (CRD #1440175, Registered Representative, Monroe, New Jersey) was barred from association with any NASD member in any capacity. The sanction was based on findings that Clark participated in private securities transactions for compensation without providing prior written notification to, and obtaining prior written approval from, two member firms with which he was associated. The findings also stated that Clark submitted a Form U4 that contained false information. (NASD Case #C9B020052)

George Alfred Cohan, Sr. (CRD #2432090, Registered Representative, Brooklyn, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Cohan consented to the described sanction and to the entry of findings that he received \$19,192.33 from insurance companies as incentive compensation in connection with applications for life insurance that identified Cohan as the insurance agent. The findings also stated that no premium payments were effected, the policies were canceled, and Cohan failed to return the funds, thereby converting the funds for his own use and benefit. NASD also found that Cohan, as the insurance agent, submitted applications for life insurance that were fictitious in that no persons authorized Cohan to submit applications for life insurance on their behalf, and, in one instance, forged the individual's signature on the application without the individual's knowledge or authorization. In addition, NASD found that Cohan received \$984.55 from an insurance company after providing the company with a check for this amount as an initial premium in connection with a life insurance application and requesting return of the funds. Cohan's check to the insurance company was returned for insufficient funds, obligating him to return \$984.55 in funds received; Cohan failed to do so, thereby converting the funds for his own use and benefit. Furthermore, the findings stated that Cohan failed to respond to NASD requests for information or documents and to appear for an on-the-record interview. (NASD Case #C10030079)

Michelle Lynn Corradetti (CRD #1871939, Registered Representative, Reno, Nevada) submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$20,000, including disgorgement of \$12,337.80 in commissions

received, and suspended from association with any NASD member in any capacity for 15 business days. Without admitting or denying the allegations, Corradetti consented to the described sanctions and to the entry of findings that she engaged in the sale of unregistered securities, acting as an underwriter, and failed to investigate adequately whether the stock could be legally sold.

Corradetti's suspension began October 20, 2003, and concluded at the close of business November 7, 2003. (NASD Case #CAF030049)

George Carlton Flanner, Jr. (CRD #2487753, Registered Representative, Toledo, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for 10 business days. In light of the financial status of Flanner, no monetary sanctions were imposed. Without admitting or denying the allegations, Flanner consented to the described sanction and to the entry of findings that he recommended to public customers that they invest approximately 89 percent of their total net worth in variable annuities without having reasonable grounds for believing that this recommendation was suitable for the customers on the basis of their financial situation, investment objectives, and needs.

Flanner's suspension began November 3, 2003, and concluded at the close of business November 14, 2003. (NASD Case #C8B030020)

Kenneth S. Friend (CRD #1715237, Registered Representative, Lake Zurich, 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, Friend consented to the described sanction and to the entry of findings that he created account statements for public customers that falsely indicated the value of investments in the accounts and provided these statements to the customers. The findings also stated that Friend failed to respond to NASD requests for information. (NASD Case #C04030053)

Paul Wilson Gillis, Jr. (CRD #1239766, Registered Principal, Murrieta, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$57,593 and suspended from association with any NASD member in any capacity for 18 months. The fine must be paid before Gillis reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Gillis consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing prior written or oral notification to, and receiving prior written approval from, his member firm.

Gillis' suspension began November 17, 2003, and will conclude at the close of business May 16, 2005. (NASD Case #C02030063)

Israel G. Grossman (CRD #4201440, Registered Representative, Brooklyn, New York) submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Grossman 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, Grossman consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on a Form U4.

Grossman's suspension began October 20, 2003, and will conclude at the close of business October 19, 2004. (NASD Case #C10020081)

David William Haburjak (CRD #2233093, Registered Representative, W. Gastonia, North Carolina) was barred from association with any NASD member. The sanction was based on findings that Haburjak changed the address of record of a public customer with the company that had issued the customer a variable annuity to the address of his member firm, without the customer's knowledge or authorization, and falsely denied that he had done so in written statements to his member firm. The findings also stated that Haburjak failed to follow the instructions of a public customer and made misrepresentations by providing the customer with a fictitious letter regarding the value of her variable annuity. NASD also found that Haburjak failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C07030028)

Concetta M. Hamilton (CRD #4612492, Associated Person, Philadelphia, Pennsylvania) 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, Hamilton consented to the described sanction and to the entry of findings that she was responsible for issuing special purpose drafts that were pre-signed by an official of the insurance company affiliated with her member firm. The findings stated that, without authorization, Hamilton prepared and issued numerous special purpose drafts to herself and to various third parties to whom she owed money in which she and the third-party payees negotiated the drafts and, as a result, Hamilton converted \$6,900 to her own use and benefit. (NASD Case #C9A030032)

Steven Spiro Hecht (CRD #2028174, Registered Representative, Marina Del Rey, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any

capacity for 90 days. In light of the financial status of Hecht, no monetary sanction has been imposed. Without admitting or denying the allegations, Hecht consented to the described sanction and to the entry of findings that he entered buy (sell) orders in NASDAQ securities into an electronic communications network (ECN) at prices that did improve, and were intended to improve, the National Best Bid or Offer (NBBO) in such securities, in that the full price and size of such orders would be reflected in the public quotation system as the best prices and sizes at which a market participant was willing to buy or sell such securities. The findings stated that, after having entered such buy (sell) orders, Hecht routed to other companies orders to sell (buy) shares of such securities on behalf of a member firm's proprietary account. NASD also found that, by knowingly and intentionally engaging in this course of conduct, Hecht sold (purchased) shares of these securities at prices that were higher (lower) than Hecht would otherwise have been able to sell (purchase) shares of these securities, but for his entry of the orders. In addition, the findings stated that, immediately after Hecht received the executions of the orders that he had entered on behalf of a member firm's proprietary account, he canceled orders that he had entered and obtained a financial benefit.

Hecht's suspension began November 3, 2003, and will conclude January 31, 2004. (NASD Case #CMS030223)

Steven Richard Jaloza (CRD #1320831, Registered Representative, Muttontown, New York) and Salvatore Anthony Fradella (CRD #1482494, Registered Principal, Manhasset, New York) submitted an Offer of Settlement in which Jaloza was fined \$10,000 and suspended from association with any NASD member in any capacity for 45 days. Fradella was fined \$7,500 and suspended from association with any NASD member in a principal or supervisory capacity for six months. Without admitting or denying the allegations, Jaloza and Fradella consented to the described sanctions and to the entry of findings that a member firm, acting through Jaloza and Fradella, issued shares of their firm's preferred stock in a private placement offering and failed to disclose in the offering memorandum that the firm provided funding to one of the business ventures. The findings also stated that Jaloza failed to inform investors that the number of customer accounts actually active was far less than what was asserted in the memorandum. NASD also found that Jaloza and Fradella failed to exercise reasonable care in connection with their decision, on behalf of their member firm, to invest in a new business venture without a meaningful examination of the company's business operations or to take the necessary steps to ensure that it was a legitimate business enterprise with a sound business plan. In addition, NASD found that Jaloza failed to ensure that his member firm made and preserved required books and records and to file its quarterly FOCUS reports with NASD.

Jaloza's suspension began November 3, 2003, and will conclude at the close of business December 17, 2003. Fradella's suspension began November 3, 2003, and will conclude May 2, 2004. (NASD Case #CLI030003)

Michael G. Kamrath (CRD #4391458, Registered Representative, Agoura, California) 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. The fine must be paid before Kamrath reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Kamrath consented to the described sanctions and to the entry of findings that he participated in private securities transactions and failed to provide his member firm with prior written notification describing each proposed transaction, stating whether he had or would receive selling compensation in connection with the transactions, and to receive prior approval from his firm to engage in the transactions.

Kamrath's suspension began November 3, 2003, and will conclude at the close of business December 15, 2003. (NASD Case #C02030056)

Jacqueline Ann Kemp (CRD #4199658, Registered Representative, St. Peters, Missouri) 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, Kemp consented to the described sanction and to the entry of findings that she misused and attempted to convert a \$400 check from a public customer. The findings stated that Kemp failed to respond to NASD requests for information. (NASD Case #C04030050)

David Allen Kettelhake (CRD #3241522, Registered Representative, Pawnee City, Nebraska) 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, Kettelhake consented to the described sanction and to the entry of findings that he misused for his own use and benefit customer funds intended for payments on insurance premiums by depositing their funds into his business checking account without the customers' consent or authorization. (NASD Case #C04030054)

John Francis Kilcommons (CRD #2418075, Registered Representative, Quincy, Massachusetts) was barred from association with any NASD member in any capacity. The sanction was based on findings that Kilcommons misused and converted a public customer's funds. The findings also stated that Kilcommons failed to respond to NASD requests for information. (NASD Case #C11030018)

Thomas Edward LaRossa (CRD #302701, Registered Principal, Boxford, Massachusetts) submitted an Offer of Settlement in which he was fined \$20,000 and suspended from association with any NASD member in a general securities principal capacity for 75 days. The fine must be paid before LaRossa reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification.

Without admitting or denying the allegations, LaRossa consented to the described sanctions and to the entry of findings that a member firm, acting through LaRossa, falsely represented to public customers and potential customers that it was a member of the MSRB. The findings also stated that LaRossa allowed his member firm to enter orders involving option contracts when it did not have a registered options principal. NASD also found that a member firm, acting through LaRossa, failed to register two sales offices as offices of supervisory jurisdiction and branch offices. In addition, NASD found that LaRossa allowed his member firm to violate its membership agreement with NASD in that he allowed the firm to change its controlling interest or management, open branch offices, enter transactions involving options contracts, and accept customer funds and securities on a routine basis without prior written notice to, and approval of, NASD. Moreover, NASD found that LaRossa failed to ensure that his member firm's supervisory system was reasonably designed to provide for the proper supervision of its operations and that the firm's written supervisory procedures adequately addressed regulatory requirements applicable to the firm's activities. Furthermore, NASD found that LaRossa failed to adequately supervise the firm's operations to reasonably achieve compliance with applicable securities laws, regulations, and NASD rules.

LaRossa's suspension began November 3, 2003, and will conclude at the close of business January 16, 2004. (NASD Case #C07030019)

James Robert Laughton, Jr. (CRD #1009597, Registered Supervisor, Reno, Nevada) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$12,500 and suspended from association with any NASD member in any principal capacity for 15 business days. Without admitting or denying the allegations, Laughton consented to the described sanctions and to the entry of findings that he failed to supervise reasonably the activities of a registered representative in the sale of unregistered stock even though several warning signs were present. The findings also stated that Laughton failed to respond to these warning signs and to assess whether the stock was registered.

Laughton's suspension began October 20, 2003, and concluded at the close of business November 7, 2003. (NASD Case #CAF030050)

Robert Waldo Leavenworth (CRD #2766524, Registered Representative, Atlanta, Georgia) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, ordered to disgorge \$5,232.86 in commissions as partial restitution to public customers, and suspended from association with any NASD member in any capacity for 90 days. The fine and disgorgement must be paid before Leavenworth reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Leavenworth consented to the described sanctions and to the entry of findings that he made unsuitable recommendations to public customers in that he failed to recommend the lowest cost alternative to customers when recommending the purchase of loaded mutual funds.

Leavenworth's suspension began September 17, 2003, and will conclude December 13, 2003. (NASD Case #C07030061)

Chris Joseph Lim (CRD #847160, Registered Principal, Chicago, 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, Lim consented to the described sanction and to the entry of findings that, acting on behalf of a member firm, he used the mails or other means or instrumentalities of interstate commerce to effect transactions in securities when the firm failed to maintain the minimum required net capital. The findings stated that Lim, acting on behalf of a member firm, prepared inaccurate trial balances and net capital computations and filed a FOCUS PART IIA report with NASD that was inaccurate and overstated the firm's net capital. Furthermore, NASD found that Lim gave unregistered individuals and an entity that was not a member of NASD a total of \$1,151,608.90, representing a percentage of the commission that the firm received from securities transactions for various customers of the firm. The findings also stated that Lim refused to respond fully to NASD questions and a request for documents. (NASD Case #C8A030073)

Jerry Michael Low (CRD #2360507, Registered Representative, Seattle, Washington) 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 Low reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Low consented to the described sanctions and the entry of findings that he executed and/or caused the execution of unauthorized transactions in the accounts of public customers without their prior knowledge, authorization, or consent.

Low's suspension began October 20, 2003, and will conclude at the close of business October 19, 2005. (NASD Case #C3B030015)

Philip Peter Marcucci, Sr. (CRD #2335911, Registered Representative, Gibbertsville, Pennsylvania) submitted an Offer of Settlement in which he was fined \$75,000 and suspended from association with any NASD member in any capacity for 15 months. The fine must be paid before Marcucci reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Marcucci consented to the described sanctions and to the entry of findings that he participated in private securities transactions outside the scope of his employment with his member firm without providing prior written notice to, or written approval from, his member firm.

Marcucci's suspension began October 6, 2003, and will conclude at the close of business January 5, 2005. (NASD Case #C9A030020)

Victor Giles Nance (CRD #1337905, Registered Representative, Clinton, Missouri) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Nance consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information and to appear for on-the-record testimony. (NASD Case #C05030052)

John Brent Packard (CRD #2777949, Registered Representative, Saratoga Springs, Utah) 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, Packard consented to the described sanction and to the entry of findings that he caused the transfer of \$400,000 from the securities account of a public customer of his member firm to a bank account that he controlled and took possession of the funds. NASD also found that Packard failed to respond to NASD requests for information. (NASD Case #C3A030042)

Mauro Jose Padilla (CRD #2753876, Registered Representative, San Antonio, Texas) 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 one month, and required to pay \$6,680 in restitution to public customers. The fine and restitution must be paid before Padilla reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Padilla consented to the described sanctions and to the entry of findings that he engaged in an outside business activity and failed to provide prompt written notice of these activities to his member firm.

Padilla's suspension began October 20, 2003, and will conclude at the close of business November 19, 2003. (NASD Case #C06030020)

James Forrest Parker (CRD #2767719, Registered Representative, New York, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Parker received a commission check from his member firm in the amount of \$2,138 and cashed the check on the same day. NASD also found that on the next day his member firm advised him that the first check had been issued erroneously, that a "stop payment" had been placed on the check, and that a second check would be issued to him in the same amount. The findings also stated that Parker failed to inform his member firm that he had already cashed the first check. NASD also found that Parker's member firm issued him a second check for \$2,138 that he cashed upon receipt. In addition, NASD determined that his firm requested, on several occasions, that Parker return the duplicate payment of \$2,138, but he failed to do so. NASD also found that Parker eventually repaid \$1,040 of the funds but has yet to repay to the firm the remaining \$1,098. (NASD Case #C9B030021)

Robert Brown Paul (CRD #828987, Registered Principal, Westminster, Colorado) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member in any principal or supervisory capacity for one year, and ordered to requalify by exam as a general securities principal before again serving in such capacity. The fine must be paid before Paul reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Paul consented to the described sanctions and to the entry of findings that he failed to adequately and properly supervise the trading activities of sales representatives at his member firm.

Paul's suspension began October 20, 2003, and will conclude at the close of business October 19, 2004. (NASD Case #C04030051)

Mark Anthony Perrelli (CRD #1170060, Registered Principal, Jupiter, Florida) 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 principal or supervisory capacity for 15 business days. Without admitting or denying the allegations, Perrelli consented to the described sanctions and to the entry of findings that he failed to reasonably supervise the activities of a registered representative.

Perrelli's suspension began on November 3, 2003, and will conclude at the close of business November 21, 2003. (NASD Case #C9B030068)

Samuel Q. Pittman (CRD #2590285, Registered Principal, Scottsdale, Arizona) 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 principal or supervisory capacity for one month. Without admitting or denying the allegations, Pittman consented to the described sanctions and to the entry of findings that, while registered with a member firm, he failed to supervise individuals in a manner reasonably designed to achieve compliance with NASD rules.

Pittman's suspension began November 3, 2003, and will conclude at the close of business December 2, 2003. (NASD Case #C3A030040)

Vincent Joseph Puma (CRD #2358356, Registered Principal, Marlboro, New Jersey) was fined \$10,000 and suspended from association with any NASD member in any capacity for 10 business days. The NAC imposed the sanctions following the appeal of an OHO decision. The sanctions were based on findings that Puma effected an unauthorized transaction in the account of a public customer.

Puma's suspension began September 22, 2003, and concluded at the close of business October 3, 2003. (NASD Case #C10000122)

Robert James Quinn (CRD #2434173, Registered Representative, White Stone, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Quinn failed to respond to NASD requests to appear for on-the-record interviews. The findings also stated that Quinn willfully failed to disclose material information on his Form U4 and failed to respond to NASD requests for information in a timely manner. (NASD Case #C10030023)

Matthew Wilhelm Sandvik (CRD #2235440, Registered Representative, Summit, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Sandvik consented to the described sanction and to the entry of findings that he made unauthorized purchases of stock in the account of a public customer. NASD found that Sandvik exercised effective control over the accounts of public customers and recommended and effected purchase and sale securities transactions in the customers' accounts without having reasonable grounds for believing that such transactions were suitable for the customers in view of the size, frequency, and nature of the recommended transactions, and in light of the customers' investment objectives, circumstances, and needs. The findings also stated that Sandvik exercised discretion in the accounts of public customers without prior written authorization of the customers and prior written acceptance of the accounts as discretionary by his member firm. (NASD Case #C9B030069)

Steve Skytte (CRD #2562942, Registered Principal, Fountain Valley, California) 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 principal capacity for 20 business days. The fine must be paid before Skytte reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Skytte 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 reasonably designed to achieve compliance with NASD rules including the establishment and maintenance of written supervisory procedures. The findings stated that Skytte failed to complete in a timely manner the Regulatory Element of NASD's Continuing Education Requirement.

Skytte's suspension began November 3, 2003, and will conclude at the close of business December 2, 2003. (NASD Case #C02030059)

Ole Leon Sorenson, Jr. (CRD #4553509, Associated Person, Gilbert, Arizona) was barred from association with any NASD member firm in any capacity. The sanction was based on findings that Sorenson failed to respond to NASD requests for information. NASD also found that Sorenson failed to disclose a material fact on his Form U4. (NASD Case #C3A030021)

Mark Gregory Steffan (CRD #1239718, Registered Principal, Kihei, Hawaii) 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, Steffan consented to the described sanction and to the entry of findings that he engaged in outside business activities for compensation without providing notification to his member firm. (NASD Case #C01030028)

Richard William Stopa (CRD #2368388, Registered Principal, Manalapan, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Stopa consented to the described sanction and to the entry of findings that, in order to circumvent New Jersey's denial of his registration application, he entered into an arrangement with another registered representative of his member firm who was properly registered in New Jersey to sell securities. The findings stated that, as part of the arrangement, Stopa falsified a New Jersey customer's account records so that the other registered representative appeared as the registered representative of record for an account actually handled by Stopa. NASD also found that Stopa received approximately \$25,000 in commissions from the other registered representative based on trading activity in that account. (NASD Case #C9B030070)

Victor Glenn Tartaglia (CRD #3021970, Registered Principal, Wayne, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and barred from association with any NASD member in a principal capacity. The fine must be paid before Tartaglia reassociates with a member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Tartaglia consented to the described sanctions and to the entry of findings that, acting on behalf of a member firm, he permitted a person he knew, or should have known, to be subject to statutory disqualification to be an associated person of the firm and to engage in the securities business of the firm without appropriate regulatory approvals. (NASD Case #C11030035)

Christopher Cosme Tavares (CRD #2975868, Registered Principal, Lake Worth, Florida) and Alfred George Marchetti (CRD #1863487, Registered Principal, Boca Raton, Florida) submitted Offers of Settlement in which Tavares was fined \$25,000, including disgorgement of ill-gotten gains of \$9,165, suspended from association with any NASD member in any capacity for four months, suspended from association with any NASD member in a principal or supervisory capacity for two years, and required not to issue any research reports or in any way contribute to the preparation of any research report for three years. Marchetti was fined \$15,000, suspended from association with any NASD member in any capacity for two months, and barred from association with any NASD member in a principal or supervisory capacity. The fine must be paid before the respondents reassociate with a member firm following the suspension or before requesting relief from any statutory disqualification.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Tavares issued a negative research report on a security, and Marchetti traded ahead of a negative research report by engaging in short sales of the securities and realized a profit of \$28,000. The findings stated that, in anticipation of issuing the negative research report, Tavares sold short 2,000 securities in his personal accounts and realized a profit of \$9,165 from his personal short selling. The findings also stated that Marchetti failed to make and annotate affirmative determinations in connection with the short sales of securities. NASD determined that Marchetti knew, or should have known, that Tavares had prepared research on a company and that he was trading in securities ahead of his research. In addition, NASD found that Tavares maintained accounts at another member firm but failed to inform the firm in writing of his association with an NASD member. Furthermore, NASD found that the respondents failed to establish and maintain a supervisory system and written supervisory procedures designed to secure compliance with securities laws and regulations. NASD also determined that Marchetti failed to supervise Tavares to ensure that he did not trade ahead of research for his personal benefit.

Tavares' suspensions began June 2, 2003; the suspension in all capacities concluded at the close of business October 1, 2003; and his suspension in a principal or supervisory capacity will conclude at the close of business June 1, 2005. Marchetti's suspension began September 24, 2003, and will conclude November 23, 2003. (NASD Case #CMS030047)

Patience Lane Taylor (CRD #1641535, Registered Supervisor, Plymouth, Massachusetts) submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$2,500 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Taylor consented to the described sanctions and to the entry of findings that she settled a customer complaint without her member firm's knowledge or approval.

Taylor's suspension began November 3, 2003, and concluded at the close of business November 14, 2003. (NASD Case #C11030034)

John Wesley Thompson (CRD #1637595, Registered Principal, Ferguson, Missouri) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Thompson consented to the described sanction and to the entry of findings that he received checks totaling \$76,089.91 from public customers to be invested and, without the knowledge or consent of the customers, deposited the checks into an account under his control, thereby converting the customers' funds to his own use and benefit. Also, the findings stated that Thompson failed to respond to NASD requests for information. (NASD Case #C04030055)

Moises Toledo (CRD #4164833, Registered Representative, Highland Beach, Florida) was barred from association with any NASD member in any capacity and ordered to pay \$99,732.35 in restitution to public customers. The sanctions were based on findings that Toledo failed to respond to NASD requests to appear for on-the-record interviews. The findings also stated that Toledo made factual misrepresentations and material omissions to public customers in the course of his sales presentations of a stock and made baseless price predictions to customers with regard to the stock. NASD also found that Toledo failed to execute sell orders of public customers. (NASD Case #CAF030010)

Charles David Traxel (CRD #4368097, Registered Representative, Renton, Washington) 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, Traxel consented to the described sanction and to the entry of findings that, without the consent or knowledge of a public customer, he affixed, or caused to be affixed, the signature of the customer to an

Indemnity Agreement Sheet, which caused a bank to stop payment of a check previously issued to the customer in the amount of \$19,952.81 in order for Traxel to obtain possession and control of the funds. The findings also stated that Traxel caused the bank to offset the funds originally issued to a public customer by issuing a credit to his personal checking account, and Traxel thereby converted \$19,952.81 of the customer's funds to his own use and benefit. (NASD Case #C3B030014)

Gary H. Untracht (CRD #4499828, Registered Representative, Florham Park, 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 three months. The fine must be paid before Untracht reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Untracht consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Form U4.

Untracht's suspension began October 20, 2003, and will conclude at the close of business on January 19, 2004. (NASD Case #C9B030067)

David Paul Vanderzee (CRD #1199435, Registered Representative, Clifton Park, 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, Vanderzee consented to the described sanction and to the entry of findings that he engaged in private securities transactions without providing written notice to, or receiving approval from, his member firm. (NASD Case #C11030033)

Eric L. Warkentine (CRD #4285882, Registered Representative, Sarasota, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$4,000 and suspended from association with any NASD member in any capacity for 42 days. The fine must be paid before Warkentine 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, Warkentine consented to the described sanctions and to the entry of findings that he failed to respond to NASD requests for information.

Warkentine's suspension began October 20, 2003, and will conclude November 30, 2003. (NASD Case #C07030063)

John William West (CRD #1290825, Registered Representative, Dunbar, West Virginia) 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 West

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, West consented to the described sanctions and to the entry of findings that he participated in private securities transactions and failed to give prior written notice of his intention to engage in such activities to his member firm and failed to receive prior written approval from his firm.

West's suspension began October 20, 2003, and will conclude at the close of business April 19, 2004. **(NASD Case #C8B030019)**

Barry Steven Wheeler (CRD #1157403, Registered Principal, Augusta, Georgia) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for five business days. In light of the financial status of Wheeler, no monetary sanctions have been imposed. Without admitting or denying the allegations, Wheeler consented to the described sanction and to the entry of findings that a member firm, acting through Wheeler, conducted a securities business without maintaining its required net capital and filed materially inaccurate FOCUS reports. The findings also stated that a member firm, acting through Wheeler, failed to maintain an accurate purchase and sales blotter for mutual fund and variable annuity transactions. NASD also found that Wheeler failed to establish, maintain, and enforce adequate written supervisory procedures for municipal securities transactions. In addition, NASD found that a member firm, acting through Wheeler, failed to develop a written training plan and failed to maintain records evidencing the content of the program and the completion of training by the firm's covered persons.

Wheeler's suspension began November 3, 2003, and concluded at the close of business November 7, 2003. **(NASD Case #C07030053)**

Individuals Fined

Joseph Lawrence Peggs (CRD #1219721, Registered Principal, Indian Rocks Beach, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$10,000. Without admitting or denying the allegations, Peggs consented to the described sanctions and to the entry of findings that he created and used violative pieces of sales literature sent to numerous public customers and prospects that emphasized the benefits of a variable annuity but failed to present a balanced discussion of the product, and he omitted material information regarding costs, risks, and restrictions. The findings also stated that the newsletters failed to disclose that certain benefits were available only if the customer paid an extra cost and that there were surrender charges and reductions in benefits if certain withdrawals were made from the product. **(NASD Case #CAF030054)**

Earl Morton Slosberg (CRD# 1652341, Registered Principal, Palm Harbor, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$25,000. Without admitting or denying the allegations, Slosberg consented to the described sanctions and to the entry of findings that he created and used advertisements and a piece of sales literature that were misleading because they suggested that individuals purchasing variable annuities would pay no fees when, in fact, they do pay fees. The findings also stated that Slosberg created and used pieces of sales literature that failed to present a balanced discussion and omitted material information regarding dollar-cost averaging. NASD also found that Slosberg used a slide presentation at seminars that failed to present a balanced discussion and omitted material information regarding a guaranteed minimum death benefit for a particular variable annuity and failed to describe the conditions and costs associated with obtaining this benefit. **(NASD Case #CAF030053)**

Decisions Issued

The following decisions have been issued by the DBCC or the Office of Hearing Officers and have been appealed to or called for review by the NAC as of October 3, 2003. The findings and sanctions imposed in the decision may be increased, decreased, modified, or reversed by the NAC. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notice to Members*.

Joseph Anthony Geraci, II (CRD #2138918, Registered Representative, Minneapolis, Minnesota) was fined \$15,000 and barred from association with any NASD member in any capacity. Geraci must pay the fine before he re-associates with a member firm or requests relief from any statutory disqualification. The sanctions were based on findings that Geraci purchased, and solicited customers to purchase, common stock on the basis of material, nonpublic information, and Geraci had unrealized profits. The findings stated that Geraci knew, or should have known, that such improper disclosure constituted a breach of fiduciary or similar duty of trust and confidence by principals of his member firm, and Geraci knowingly purchased stock on the basis of such material, nonpublic information. In addition, NASD found that Geraci, directly or indirectly, by use of means or instrumentalities of interstate commerce, intentionally or recklessly employed a device, scheme, or artifice to defraud, or engaged in an act, practice, or course of business that would operate as a fraud or deceit in connection with the purchase or sale of a security.

Geraci has appealed this action to the NAC, and the sanctions are not in effect pending the NAC's consideration of the decision. **(NASD Case #CMS020143)**

J. Alexander Securities, Inc. (CRD #7809, Los Angeles, California), Richard Leon Newberg (CRD #346857, Registered Principal, Aventura, Florida), and James Alexander (CRD #2762, Registered Principal, Los Angeles, California). The firm was fined \$90,000, jointly and severally with Alexander, fined \$22,000 solely, and required to retain, at its own expense, an independent consultant for 18 months, during which time the consultant shall develop appropriate supervisory procedures in accordance with the conditions set forth in the decision. Newberg was barred from association with any NASD member in any capacity, and Alexander was suspended from association with any NASD member in any capacity for 90 days.

The sanctions were based on findings that the firm and Newberg engaged in the distribution of unregistered securities. NASD also found that the firm and Newberg engaged in manipulation by participating in matched trades that gave the appearance of market activity. In addition, NASD found that the firm filed false Form 211 filings. Moreover, NASD found that Newberg failed to notify his member firm prior to opening securities accounts at other firms and failed to give prompt written notice to the firm that he was engaged in outside business activities. Furthermore, NASD found that Newberg provided false testimony during an NASD on-the-record interview. NASD also found that the firm and Alexander failed to review Forms 211 and failed to maintain the requisite written supervisory procedures concerning Forms 211 and other matters involving shell companies.

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #CAF010011)

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.

Maurice Wayne Abney (CRD #2733649, Registered Principal, Owensboro, Kentucky) was named as a respondent in an NASD complaint alleging that he recommended and effected transactions in the account of a public customer without having reasonable grounds for believing that the recommendation and resultant transactions were suitable for the customer on the basis of the customer's financial situation and needs. (NASD Case #C05030046)

Keith Jacob Andrews (CRD #2089621, Registered Representative, Romeoville, Illinois) was named as a respondent in an NASD complaint alleging that he converted customer funds by endorsing a \$10,000 check made payable to a public customer, and deposited the check into an account he controlled for his own use and benefit, without the customer's authorization, knowledge, or consent. The complaint also alleges that Andrews failed to respond to NASD requests for information. (NASD Case #C8A030070)

Christopher Alan Booze (CRD #3263962, Registered Representative, Lexington, Kentucky) was named as a respondent in an NASD complaint alleging that he completed an instruction form directing that a \$3,200 check be issued from a public customer account, and that the check be made payable to a third party and given to him without the customer's knowledge or consent, thereby making improper use of customer's funds. The complaint also alleges that Booze created and sent to a public customer an account statement incorrectly reflecting an overstated value in the customer's account. In addition, the complaint alleges that Booze failed to respond to NASD requests for information. (NASD Case #C05030048)

Jaime Antonio Flechas (CRD #2837750, Registered Representative, Flowood, Mississippi) was named as a respondent in an NASD complaint alleging that he arranged for the transfer of \$18,500 from the account of a public customer to his personal firm account without the customer's authorization or consent. The complaint also alleges that Flechas failed to respond to NASD requests for information. (NASD Case #C05030047)

James Richard Gonzales (CRD #4235861, Registered Representative, Plano, Texas) was named as a respondent in an NASD complaint alleging that he executed unauthorized securities transactions in the accounts of public customers. The complaint also alleges that, without the customers' knowledge or consent, he entered false identification numbers for public customer accounts into his member firm's computer records in order to execute unauthorized transactions. The complaint also alleges that Gonzales failed to respond to NASD requests for information. (NASD Case #C05030050)

Roger A. Kapsalis (CRD #2159293, Registered Representative, Brooklyn, New York) was named as a respondent in an NASD complaint alleging that he either intentionally or recklessly failed to disclose materially adverse information to public customers in connection with his recommendations that customers purchase stock. The complaint also alleges that Kapsalis either intentionally or recklessly failed to disclose to customers his financial incentive for recommending a stock. In addition, the complaint alleges that Kapsalis acted in contravention of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder in that, by use of the means or instrumentalities of interstate commerce, or of the

mails, or of any facility of any national securities exchange, he employed a device, scheme, or artifice to defraud; omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or a course of business which operated or could operate as a fraud or deceit upon persons, in connection with the recommendations he made to customers to purchase stock. **(NASD Case #C3A030041)**

Cara Ann Miller (CRD #2968371, Registered Representative, Florence, Kentucky) was named as a respondent in an NASD complaint alleging that she forged signatures in order to liquidate certificates of deposit owned by a public customer totaling \$7,322.58, and converted the funds to her own use and benefit without the customer's knowledge or consent. **(NASD Case #C05030051)**

Robert W. Oakes, Jr. (CRD #1396707, Registered Principal, Rumson, New Jersey) was named as a respondent in an NASD complaint alleging that he 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 stock, thereby acting as an underwriter of the unregistered securities. The complaint also alleges that Oakes exercised discretion in the accounts of public customers and effected, or caused to be effected, transactions without having a written agreement with the customers to exercise discretion and without having obtained his member firm's prior written acceptance of each account as discretionary. **(NASD Case #CAF030052)**

Sean Donald Pascoe (CRD #2331266, Registered Representative, Boca Raton, Florida) was named as a respondent in an NASD complaint alleging that he effected unauthorized purchases in the accounts of public customers. The complaint also alleges that Pascoe failed to respond to NASD requests to appear for an on-the-record interview. **(NASD Case #C07030060)**

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

Camden Securities, Inc.
Los Angeles, California
(September 24, 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.)

Altvater, Frederick R.
Bluffton, Ohio
(September 11, 2003)

Avella, Jr., Michael
Remsenburg, New York
(September 30, 2003)

Bautz, Phil D.
Madison, Wisconsin
(September 3, 2003)

Kyro, Thomas J.
Scottsdale, Arizona
(September 30, 2003)

Pepio, James
Garden City, New York
(September 3, 2003)

Peters, Troy M.
Solana Beach, California
(September 24, 2003)

Roginson, Thomas
Los Angeles, California
(September 11, 2003)

Starominski, Yevgeny
Forest Hills, New York
(September 24, 2003)

Strunk, David A.
Warren, Michigan
(September 11, 2003)

Supinsky, Jeffrey H.
Woodbury, New York
(September 11, 2003)

Thalheim, David
Old Westbury, New York
(September 30, 2003)

Thalheim has appealed this decision to the SEC (NASD Case # 8210-10030008)

Torres, Roger E.
Miami, Florida
(September 17, 2003)

Vogt, Jr., Ronald William
Richmond, Virginia
(September 17, 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.)

Bush, Brandon T.
Boca Raton, Florida
(September 10, 2003)

Carrea, Anthony J.
Chesapeake, Virginia
(September 11, 2003)

Carroll, Kim Sang
Lake Forest, California
(September 17, 2003)

Charlton, Michael E.
Nashville, Tennessee
(September 26, 2003)

McDonald, Stephen
Daniel Island, South Carolina
(September 24, 2003)

Menlove, Troy
Sandy, Utah
(September 11, 2003)

Signorelli, Jr., Joseph
Parkland, Florida
(September 30, 2003)

Willis, John Carl
Englewood, Florida
(October 3, 2003)

Individuals Revoked for Failing to Pay Fines and/or Costs in Accordance with NASD Rule 8320

Byrum, Lindsay A.
Houston, Texas
(September 24, 2003)

Chase, James B.
Milwaukee, Wisconsin
(September 24, 2003)

Lipsky, Robert M.
Bellmore, New York
(September 24, 2003)

NASD Charges Peter Kellogg With Fraudulent Wash And Matched Trades

NASD has filed a disciplinary action against Peter Kellogg, senior partner of Spear, Leeds & Kellogg, L. P., alleging that Kellogg directed fraudulent wash trades and matched trades between four accounts he controlled.

The NASD complaint charged that between Aug. 1, 2001, and Aug. 13, 2001, Kellogg placed matched orders to buy and sell millions of shares of Thoratec Corp. common stock for four accounts he controlled, and in which he and his family had ownership interests. These trades resulted in minimal change of ownership in the shares of Thoratec, were executed at prices unrelated to market supply and demand, and created the false appearance of market activity in the stock. Kellogg indicated to NASD he directed these trades to recognize non-taxed capital gains in Thoratec stock held by I.A.T. Reinsurance Syndicate, Ltd., a Bermuda corporation owned by Kellogg's children, and Equity Holding, Inc., whose parent company, MCM, Inc., was owned in part by IAT. Kellogg also indicated that the trades were directed between accounts he controlled so that IAT and EH could recognize non-taxed gains while the accounts Kellogg controlled retained ownership of the Thoratec stock.

On Aug. 1, 2001, Kellogg directed Equity Holding to sell 700,000 shares of Thoratec to IAT. Six days later, Kellogg directed IAT to sell 1 million shares of Thoratec back to Equity Holding. On August 9, Kellogg directed IAT to sell 1 million shares of Thoratec, in two 500,000-share trades, to Kellogg's personal account and to MMK Reinsurance, a company owned by IAT. Four days later, Kellogg reversed those trades by directing the sale of the 1 million shares back to IAT.

As a result of these series of wash and matched trades, IAT recognized tax-exempt gains on sales of 2 million shares of Thoratec, while its holdings decreased by only 300,000 shares. Equity Holding recognized gains on the sale of the 700,000 shares of Thoratec while its holdings increased from 700,000 shares to 1 million. The accounts of Kellogg and MMK, which were used as the conduits for IAT's wash and matched trades on August 9 and August 13, did not have any change in their ownership of Thoratec.

Wash sales are trades of securities without a real change in ownership of the securities traded. Matched orders are orders to buy or sell securities that are entered with knowledge that a matching order on the opposite side has been or will be entered.

The complaint alleges that Kellogg, through these series of wash and matched trades, violated the antifraud provisions of the NASD rules and federal securities laws, and the NASD rule prohibiting the publication of reports of non-bona fide securities transactions. As a result of Kellogg's fraudulent trades, the companies owned by Kellogg's children recognized a greater profit than they would have received in the open market, and the trading public was deceived about the volume of trading in Thoratec stock and the prices at which that stock traded.

Under NASD rules, a firm or individual named in a complaint can file a response and request a hearing before an NASD disciplinary panel. Possible sanctions include a fine, censure, suspension, or bar from the securities industry, disgorgement of gains associated with the violations, and payment of restitution.