

SEPTEMBER 2003

# Notices to Members

## Notices

- |              |                                                                                                                                                                                                                                             |     |
|--------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| <b>03-49</b> | NASD Requests Comment on Proposed Amendments to Rule 3010 to Require Heightened Supervision Plans for Associated Persons with a Specified Threshold of Industry/Regulatory-Related Events<br><b>Comment Period Expires October 10, 2003</b> | 509 |
| <b>03-50</b> | NASD Reminds Member Firms of their Obligations Regarding Mutual Fund Transactions and Directs Review of Policies and Procedures                                                                                                             | 517 |
| <b>03-51</b> | Amendments to Article VIII of the By-Laws of NASD Regulation, Inc., Regarding District Committees and District Nominating Committees                                                                                                        | 521 |
| <b>03-52</b> | Nominees for District Committee and District Nominating Committee                                                                                                                                                                           | 537 |
| <b>03-53</b> | SEC Announces Immediate Effectiveness of Amendments to Non-Cash Compensation Provisions of Rule 2710 and Rule 2810                                                                                                                          | 553 |
| <b>03-54</b> | NASD Requests Comment on Proposed Amendments to Rule 2830 (Investment Company Securities). <b>Comment Period Expires October 17, 2003</b>                                                                                                   | 563 |

OVER



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## Notices

- |              |                                                                                                                                                                                                                                                                            |     |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----|
| <b>03-55</b> | SEC Approves Changes to Rules on Reporting of Transactions through Electronic Communications Networks (ECNs); Changes Effective October 6, 2003. Note: The effective date of the amendments to ECN Trade Reporting Rules have been delayed until Monday, October 27, 2003. | 575 |
| <b>03-56</b> | Rule Amendments to Require Member Applicants to File Forms U4 Electronically; Operative Date: October 27, 2003                                                                                                                                                             | 589 |
| <b>03-57</b> | Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory                                                                                                                                                                                | 597 |
| <b>03-58</b> | NASD Issues Interpretive Guidance to the Trade Reporting and Compliance Engine Rules (TRACE Rules)                                                                                                                                                                         | 615 |

## Disciplinary and Other NASD Actions Reported for September D1

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# Notice to Members

SEPTEMBER 2003

REQUEST FOR COMMENT

ACTION REQUESTED BY OCTOBER 10, 2003

## SUGGESTED ROUTING

Legal & Compliance  
Senior Management

## Supervision Rules

NASD Requests Comment on Proposed Amendments to Rule 3010 to Require Heightened Supervision Plans for Associated Persons with a Specified Threshold of Industry/Regulatory-Related Events; **Comment Period Expires October 10, 2003**

## KEY TOPICS

Rule 3010  
Supervisory Systems

## Executive Summary

NASD requests comment on proposed amendments to Rule 3010 (Supervision) to require members to adopt heightened supervision plans for those associated persons who have met or exceeded specified threshold numbers of industry/regulatory-related events, or to document their rationale (which must be reasonable) for not doing so. Rule 3010 generally requires members to establish and maintain supervisory systems for each of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and NASD rules. However, the rule does not specifically address supervision of associated persons with a history of industry/regulatory-related events. The proposed rule change is intended to bolster investor protection by promoting earlier and more effective detection, and thus prevention, of future sales practice and other regulatory abuses by the associated person(s) requiring heightened supervision. In connection with the heightened supervision requirement, NASD seeks comment on the types and frequency of incidents that should be considered in requiring that persons be subject to heightened supervision plans.

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NASD further requests comment on amendments that would require that the registered person responsible for supervising the activities of the associated person(s) subject to the plan approve in writing the heightened supervision plans. As part of the approval of the plan, the supervisor would acknowledge responsibility for execution of the plan. This rule change is intended to ensure effective implementation of the heightened supervision plans and coordination between the personnel responsible for hiring and compliance personnel by encouraging more awareness and careful consideration of a person's background during the hiring process.

### Questions/Further Information

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

### Request for Comment

NASD requests comment on the proposed amendments to Rule 3010 described in this *Notice*. Members wishing to comment must make a submission that is received by **October 10, 2003**. Members and interested persons can submit their comments using the following methods:

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

Written comments submitted via hard copy should be mailed to:

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

**Important Note:** The only comments that will be considered are those submitted by mail, e-mail, or via the NASD Web Site.

Before becoming effective, any rule change developed as a result of responses received to this *Notice* must be approved by the Securities and Exchange Commission (SEC).

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## Background and Discussion

Supervisory systems are a basic component of self-regulation within the securities industry. An effective supervisory system plays an essential role in the prevention of sales practice and other abuses and, thus, enhances investor protection and market integrity. As such, it is essential that firms monitor the regulatory histories of their associated persons and establish additional measures to supervise the activities of those associated persons with greater potential of creating customer harm.

Persons who have engaged in certain types of serious misconduct become subject to statutory disqualification under the federal securities laws and NASD rules and are required to undergo an eligibility proceeding.<sup>1</sup> In such a proceeding, NASD may seek to prevent the entry or continuance in the securities industry of persons subject to a statutory disqualification, or may permit them to work if the employment is consistent with the public interest and protection of investors. NASD, in virtually every instance where continued employment is permitted, will condition employment of the individual on the establishment of safeguards, including enhanced supervision by the employer member of the individual's business activities.

Neither the federal securities laws nor NASD rules, however, explicitly address members' supervisory obligations with respect to associated persons who have a history of industry/regulatory-related incidents, but who fall short of triggering the statutory disqualification provisions. Rule 3010 generally requires members to establish and maintain supervisory systems for each of their associated persons that are reasonably designed to achieve compliance with applicable securities laws and NASD rules, but the rule does not specifically address supervision of associated persons with a history of industry-related events.<sup>2</sup> *Notices to Members* issued in this area have provided guidance for members concerning heightened supervision plans for associated persons with these types of histories, but the guidance has not been incorporated into NASD rules.<sup>3</sup>

Accordingly, to address regulatory concerns raised by associated persons with these histories, NASD is seeking comment on the adoption of rule amendments to require explicitly that members adopt heightened supervision plans for those associated persons who meet or exceed threshold numbers of industry/regulatory-related incidents (such as customer complaints, arbitration proceedings, terminations for cause, and disciplinary actions). Along with numerical threshold tests, NASD recognizes that a qualitative analysis of the associated persons' activities also is an important tool for identifying whether they require heightened supervision. As such, the proposed amendments would provide firms with the flexibility not to impose a heightened supervision plan on a particular individual based upon a qualitative review of the activities of that individual. If a member decides not to impose heightened supervisory procedures on a person who has met one or more of the triggers, the member must document a clear, well-reasoned rationale supporting its determination. NASD requests comment on whether firms that have a certain number of associated persons who meet the heightened supervision requirements should not be allowed to opt-out of the heightened supervision requirement, and, if so, what this threshold number should be.

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As required by Rule 3010, any supervision plan should be reasonably designed to ensure compliance with applicable securities laws and regulations and NASD rules. However, members would have the flexibility to tailor the plans to fit the firm's business and to address the nature of the concerns raised by the associated person's industry/regulatory-related incidents. Members also would have discretion in determining the duration of a heightened supervision plan, based on the member's reasonable assessment of the facts and circumstances surrounding the particular associated person's activities. While a member would be expected to maintain any heightened supervision plan imposed until such time that the associated person no longer meets any of the triggers for heightened supervision, the member may determine to eliminate such plan earlier provided the member provides a reasonable rationale for the earlier termination.

The proposed amendments would require that the plans be approved in writing by the person responsible for supervising the associated person subject to the plan. As part of the approval of the plan, such supervisor would acknowledge responsibility for execution of the plan. NASD believes that requiring approval and acknowledgement by a supervisor would help to ensure effective implementation of the plans as well as an even more careful consideration of an associated person's background in the hiring process. In addition, as required by Rule 3010(b)(4), members would need to maintain such plans in their firm records. NASD staff would review the plans as part of the examination program.

As part of this initiative, NASD staff has reviewed CRD data regarding industry/regulatory events for persons currently registered with NASD to determine what numerical tests would be appropriate as triggers to require firms to assess whether to impose a heightened supervision plan. A preliminary review of existing data as reported to the CRD system indicates that 29,500 out of the 663,000 persons currently registered with NASD (approximately four percent of currently active registered persons) have been subject to one or more customer complaints and arbitrations within the last five years. Of this number, 2,751 persons (.41 percent of all registered persons) have had three or more complaints and arbitrations.<sup>4</sup>

Based on this preliminary data, NASD proposes that members be required to impose (or document their rationale, which must be reasonable, for not imposing) heightened supervision plans on any associated person subject to three or more customer complaints and arbitrations within the past five years, given that three or more complaints and arbitrations is an unusually high number of complaints and arbitrations in the industry. Similarly, NASD proposes that members be required to impose heightened supervision plans on their associated persons who, within the previous five years, were subject to three or more pending, adjudicated, or settled regulatory actions or investigations,<sup>5</sup> or two or more terminations relating to regulatory or compliance issues or internal reviews initiated by an employing member firm to examine whether an individual engaged in misconduct.<sup>6</sup> The preliminary universe of persons reported in this *Notice* who would trigger the heightened supervision requirement include some overlap between categories as well as overlap due to a positive reporting in more than one category based on the same incident. NASD intends to periodically review the methodology to ensure that the appropriate associated persons are identified for heightened supervision.

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Finally, while the proposed amendments would require members to adopt heightened supervision plans (unless members document their rationale for not imposing heightened supervision) if certain triggers are reached, members would continue to be obligated to review those associated persons with lower numbers of the events discussed in this *Notice*, other regulatory and litigation events, or other instances where they are the subject of internal actions by members to caution, discipline, or limit their activities, to determine whether heightened supervision plans or other measures are needed.

## Endnotes

- 1 Events triggering statutory disqualification include, for example, certain enumerated misdemeanor and all felony criminal convictions for a period of ten years from the date of conviction; temporary and permanent injunctions (regardless of their age) involving a broad range of unlawful investment activities; bars (and current suspensions) ordered by the SEC or a self-regulatory organization (SRO); and findings that a person willfully has made or caused to be made false statements of a material fact to an SRO. See Sections 3(a)(39) and 15(b)(4)(A) of the Securities Exchange Act of 1934; NASD By-Laws Article III, Section 4. Persons who are or become subject to a statutory disqualification may seek to enter, reenter, or in the case of incumbents, continue in the securities industry.
- 2 Rule 3010(a)(7) requires that members conduct annual meetings with their registered representatives at which compliance matters relevant to the activities of the representatives are discussed, but does not require that members take supervisory steps tailored to specific incidents concerning the registered representatives.
- 3 See *Notice to Members 97-19* (April 1997) stating that a member with a registered representative who develops a history of customer complaints, final disciplinary actions involving sales practice abuse or other customer harm, or adverse arbitration decisions should consider developing special supervisory procedures for that registered representative. See also *Notice to Members 98-38* (May 1998) indicating that unexpected supervisory visits to offices with personnel who have disciplinary records may be appropriate.
- 4 The preliminary data show that of the 29,500 persons subject to customer complaints within the last five years, 3.3 percent of all registered persons (22,003 persons) were subject to 1 complaint, .71 percent of all registered persons (4,726 persons) were subject to 2 complaints, .22 percent of all registered persons (1,487 persons) were subject to three complaints, .09 percent of all registered persons (568 persons) were subject to four complaints, and .04 percent of all registered persons (290 persons) were subject to 5 complaints.
- 5 Preliminary data indicate that .52 percent of all persons currently registered with NASD (3,446 persons) have been subject to regulatory actions or investigations within the last five years. Of those subject to such actions/investigations, only .03 percent of all registered persons (216 persons) were subject to three or more.
- 6 Preliminary data indicate that .37 percent of all registered persons (2,475 persons) have been terminated or been the subject of an internal review initiated by the firm based on alleged investment-related misconduct. Of those persons, .18 percent of all registered persons (1,198 persons) had two or more such incidents.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### 3010. Supervision

(a) No change.

(b) **Written Procedures**

(1) and (2) No change.

(3) Heightened supervisory procedures

(A) Each member that either is notified by NASD or otherwise has knowledge that any of its associated persons meets one of the criteria in paragraph (b)(3)(D) shall establish, maintain, and enforce special written procedures for supervising the activities of such associated persons.

(B) The member must establish and implement the supervisory procedures required by this paragraph within 30 days of receiving notice from NASD or obtaining actual knowledge that it is subject to the provisions of this paragraph.

(C) The procedures required by this paragraph must be appropriate for the member's business, size, structure, and customers and must be reasonably designed to supervise the types of activities that gave rise to the special supervision required by this paragraph.

(D) Members shall be required to adopt special supervisory procedures over the activities of the following associated person(s):

- The associated person has been subject to three or more customer complaints and arbitrations (as reported on Item 14I on Form U-4) in the previous five years;
- The associated person has been subject to three or more pending, adjudicated, or settled regulatory actions or investigations by the Commission, the Commodity Futures Trading Commission, a federal, state, or foreign regulatory agency, or a self-regulatory organization in the previous five years; or

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- The associated person has been subject to two or more terminations for cause or internal reviews for alleged investment-related misconduct in the previous five years.

(E) A member must maintain the special supervisory procedures until such date that the associated person no longer meets any one of the criteria in paragraph (b)(3)(D), unless the member documents reasonable rationale for earlier termination of such procedures.

(F) If a member determines not to adopt special supervisory procedures for an associated person who meets one or more of the criteria in paragraph (b)(3)(D), the member must have a reasonable basis for its determination, which must be documented.

(G) The special supervisory procedures established under this paragraph must be approved, in writing, by a person supervising the associated person subject to the special supervisory procedures. The approving supervisor must also acknowledge responsibility for implementation and execution of the special supervisory procedures.

(4) [(3)] The member's written supervisory procedures shall set forth the supervisory system established by the member pursuant to paragraph (a) above, and shall include the titles, registration status and locations of the required supervisory personnel and the responsibilities of each supervisory person as these relate to the types of business engaged in, applicable securities laws and regulations, and the Rules of this Association. The member shall maintain on an internal record the names of all persons who are designated as supervisory personnel and the dates for which such designation is or was effective. Such record shall be preserved by the member for a period of not less than three years, the first two years in an easily accessible place.

(5) [(4)] A copy of a member's written supervisory procedures, or the relevant portions thereof, shall be kept and maintained in each OSJ and at each location where supervisory activities are conducted on behalf of the member. Each member shall amend its written supervisory procedures as appropriate within a reasonable time after changes occur in applicable securities laws and regulations, including the Rules of this Association, and as changes occur in its supervisory system, and each member shall be responsible for communicating amendments through its organization.

(c) - (g) No change.

# Special Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal and Compliance  
Mutual Fund Sales  
Operations  
Senior Management

## KEY TOPICS

Mutual Fund Transactions

## ACTION REQUIRED

### Mutual Fund Transactions

NASD Reminds Member Firms of their Obligations  
Regarding Mutual Fund Transactions and Directs  
Review of Policies and Procedures

#### Executive Summary

Investment Company Act Rule 22c-1(a) generally requires that redeemable securities of investment companies be sold and redeemed at a price based on the net asset value (NAV) of the fund computed **after** the receipt of orders to purchase. It is a violation of NASD Rule 2110, and may be a violation of the federal securities laws and NASD Rule 2120, for member firms and their associated persons to knowingly or recklessly effect mutual fund transactions that are priced based on NAV that is computed prior to the time the order to purchase or redeem was given by the customer. Furthermore, it may be a violation of NASD Rule 2110 and the federal securities laws to knowingly or recklessly facilitate certain mutual fund transactions, such as market timing transactions, in conjunction with, or with the acquiescence of, a mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person<sup>1</sup> where those other parties acted contrary to a representation made in the prospectus or statement of additional information pursuant to which the mutual fund shares are offered.

NASD is issuing this *Notice to Members* to (1) remind members of their responsibility to ensure that they have policies and procedures reasonably designed to detect and prevent the occurrence of mutual fund transactions that would violate NASD Rule 2110 and the federal securities laws; and (2) direct each member firm executing mutual fund sales and redemptions to review its policies and procedures to assure that they are adequate with respect to the matters that are discussed in this *Notice to Members*.

03-50

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## Questions/Further Information

Questions concerning this *Notice* may be directed to Marc Menchel, Executive Vice President and General Counsel, Regulatory Policy and Oversight, NASD (202) 728-8071; Daniel M. Sibears, Senior Vice President & Deputy, Department of Member Regulation, Regulatory Policy and Oversight, NASD (202) 728-8221; or Tom Selman, Senior Vice President, Investment Companies/Corporate Finance, NASD (240) 386-4500.

## Discussion

Investment Company Act Rule 22c-1(a) essentially requires the forward pricing of mutual fund shares. In practice, mutual fund companies usually calculate their NAVs at the close of trading (4:00 p.m. EST). The purpose of the rule is to place all purchasers of mutual fund shares on equal footing as to price and information on any one day. Investors who seek to purchase or redeem mutual fund transactions after the close of trading at the NAV calculated for the same trading day gain the possibility of an information advantage based on after-close news that could affect the mutual fund's holdings but is not reflected in the NAV pricing for that day.

Member firms and their associated persons that knowingly or recklessly effect or facilitate an after-close mutual fund purchase or redemption at the same day's NAV (late trading) violate NASD Rule 2110, which requires the observance of just and equitable principles of trade. Such conduct may also be violative of the federal securities laws and NASD Rule 2120. Late trading is not excused or mitigated as a result of the consent or acquiescence of a mutual fund company, mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person.

Member firms executing mutual fund purchases and redemptions must have and implement policies and procedures reasonably designed to detect and prevent the occurrence of late trading. Member firms should pay particular attention to policies and practices regarding the entry of trades time stamped before or at the close but entered or executed after the close.<sup>2</sup> Similarly, members should take steps reasonably designed to ensure that their systems to correct errors after the close cannot be subverted for the purposes of effecting late trading.

In addition, member firms and their associated persons who knowingly or recklessly undertake, effect, or otherwise facilitate transactions in conjunction with, or with the acquiescence of, a mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person where these other parties would have acted contrary to a representation made in the prospectus or statement of additional information (SAI) pursuant to which the mutual fund shares are offered violate NASD Rule 2110 and may be found to have violated the federal securities laws and NASD Rule 2120.

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For example, certain mutual fund companies represent in their prospectuses or SAs that they engage in practices that are intended to prevent or control market timing transactions. Market timing transactions include mutual fund trades that occur when the purchaser or seller believes that the mutual fund's NAV does not fully reflect the value of the fund's holdings – for example, when the fund has in its portfolio particular holdings, such as foreign or thinly traded securities, which are priced on a basis that does not include the most updated information possible. In order to retard the efforts of investors who seek to profit on these pricing inefficiencies by executing mutual fund trades on a day when the NAV likely will not fully reflect the value of a fund's holdings and realizing the profit by trading the next day, some mutual fund companies have implemented measures to counteract the efforts of timers and have represented in their prospectuses or SAs that they are conducting these measures. Consequently, where the mutual fund company and/or its affiliated persons have represented that they have taken steps to protect investors from market timers, a member firm and its associated persons may not knowingly or recklessly act in conjunction with, or with the acquiescence of, the fund and/or its affiliated persons to undertake, effect, or facilitate a market timing transaction. Again, members must have in place policies and procedures reasonably designed to detect and prevent this collusion with mutual funds and their affiliated persons to circumvent the mutual funds stated procedures.

Members must review the adequacy of their policies and practices with regard to the matters discussed in this *Notice to Members*. NASD intends to examine for reasonable policies and practices with regard to these matters.

## Endnotes

- 1 As used in the this *Notice to Members*, the term "affiliated person" is as defined under Section 2(a)(3) of the Investment Company Act of 1940.
- 2 There may be situations where member firms legitimately receive orders prior to or at the close of trading but enter such orders after market's close. However, members bear the burden of demonstrating that they have implemented policies and procedures that are reasonably designed to prevent the occurrence of late trading.

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# Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Article VIII NASD Regulation By-Laws  
District Committees  
District Nominating Committees

INFORMATIONAL

## District Committees and District Nominating Committees

Amendments to Article VIII of the By-Laws of NASD Regulation, Inc., Regarding District Committees and District Nominating Committees

### Executive Summary

On March 21, 2003, NASD filed with the Securities and Exchange Commission (SEC) a proposed rule change to amend Article VIII of the By-Laws of NASD Regulation, Inc. (By-Laws), to streamline the nomination and election processes governing District Committees and District Nominating Committees (collectively, the Committees), modernize communication procedures, and improve consistency among the Committees across all Districts.<sup>1</sup> The filing was designated as a “non-controversial” rule change and by its terms would have become operative on June 6, 2003. However, to avoid any confusion during this year’s Committee election cycle that was already underway, NASD submitted a subsequent rule filing with the SEC to delay the implementation date of the amendments to January 1, 2004.<sup>2</sup> NASD is conducting this year’s District Committee and District Nominating Committee elections in accordance with the provisions of Article VIII of the By-Laws as in effect prior to the filing of these rule changes.

Article VIII of the By-Laws of NASD Regulation, Inc., as amended, is set forth in [Attachment A](#).

Questions concerning this *Notice* may be directed to Kosha K. Dalal, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-6903.

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## Background and Discussion

Article VIII of the By-Laws sets forth provisions relating to the operation of District Committees and District Nominating Committees, including specifically, provisions regarding Committee meetings, vacancies, and elections. Under Article VIII, the role of the District Committee members includes serving as panelists in disciplinary proceedings in accordance with NASD rules, recommending policy and rule changes to the Board, educating members in their District, and selecting members of the regional District Committee and District Nominating Committees in a manner consistent with Article VIII of the By-Laws. The role of the District Nominating Committee includes nominating candidates to serve on the District Committee and District Nominating Committee for that region.

Currently, there are 11 District Committees, divided by geographic region. Based on the experience of NASD staff in working with the Committees since that time, and the current practices of the Committees, NASD has adopted a series of amendments to modernize and clarify the Article VIII provisions. The amendments are designed to streamline the nomination and election processes by, among other things, centralizing the communication procedures in the Corporate Secretary's Office, revising the nomination and election timeline, and modernizing the methods of communication by permitting electronic delivery of documents. In addition, the amendments will improve coordination and consistency among the Committees across the Districts, modify the procedures to fill vacancies, and provide for more administrative flexibility.

The key amendments are discussed below.

### **Section 8.2 (Composition of District Committees) and Section 8.9 (Composition of District Nominating Committees)**

*Create Consistency in Size of Committee.* To create more consistency in District Committee sizes across Districts, the amendments allow the Board of Directors (Board) to determine the size of each Committee.

*Clarify Qualifications to Serve on Committee.* The amendments clarify the qualifications necessary to serve as a member of a Committee. The amendments provide that a member must: (1) be employed by an NASD member eligible to vote in the District for District Committee elections; and (2) work primarily from such NASD member's principal office or a branch office that is located within the District where the member serves on a Committee. NASD believes this will ensure that local interests are represented on Committees.

*Eliminate Requirement in Section 8.9 that One District Nominating Committee Member be a Current or Former Director or Governor.* The amendments eliminate the requirement that at least one member of the District Nominating Committee be a current or former Director or Governor. Based on the experience of NASD staff, it has become increasingly difficult to satisfy this composition requirement.

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**Section 8.3 (Term of Office of District Committee Member) and Section 8.10 (Term of Office of District Nominating Committee Member)**

*Clarify Term of Office.* The amendments clarify that there is no limit on the number of terms that a Committee member may serve, provided a member may not serve more than two consecutive terms. The word “term” is defined to include either a full term (three years for District Committees or one year for District Nominating Committees) or any partial term where a member is appointed to fill a vacancy. NASD believes that this will allow for greater member participation in the Committees over time.

**Section 8.4 (Filling of Vacancies on District Committee) and Section 8.9 (Filling of Vacancies for District Nominating Committees)**

*Streamline Process for Filling Vacancies.* The amendments clarify that Committee members may formally resign from their positions by serving a notice to the Chair. In addition, the amendments provide a process for filling vacancies. Under the amendments, the Executive Vice President, Regulatory Policy and Programs, the Executive Vice President, Member Regulation, or their respective designee(s) are authorized to determine whether a vacancy created on the Committee needs to be filled. In some instances there may not be a need to fill a vacancy immediately – for example, when there is no scheduled meeting between the time of the vacancy and the next regularly scheduled election. If a determination is made to fill a vacancy or where a new position is created by an increase in Committee size, the Committee would fill such vacancy by a majority vote of a quorum present at a meeting in accordance with the provisions of Sections 8.4 (District Committee) and 8.11 (District Nominating Committee).

**Section 8.5 (Meetings of District Committee) and Section 8.12 (Meetings of District Nominating Committees)**

*Coordinate Procedures for Meetings.* To simplify and better coordinate Committee meetings across Districts, the amendments authorize the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) to determine the times, places, and procedures for Committee meetings in consultation with the Chair of each Committee. In addition, the amendments clarify that an individual may attend a meeting either in person or by telephone and that action taken by telephonic vote will not require written confirmation.

**Section 8.6 (Election of District Officers) and Section 8.13 (Election of District Nominating Committees)**

*Eliminate Requirement to Designate Function of Committee Officers.* The amendments eliminate the requirement for Committees to prescribe the powers and duties of its elected officers because Committees have not found it necessary to perform this function.

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## Section 8.7 (Advisory Council)

*Members to Advisory Council.* The amendments clarify that the Chair of the Market Regulation Committee of NASD is a member of the Advisory Council to the Board.

## General Amendments to Allow Electronic Communications

The amendments provide that where provisions in Article VIII call for notice and other communications to be given either among Committee members, or between Committees and NASD staff, the requirement may be satisfied by electronic means provided the person entitled to notice consents to receive notice in this manner. Specifically, the amendments define the term "Notice" as used in Article VIII to mean a notice in writing or by electronic transmission.

## General Amendments to Centralize Procedures for Nominations and Elections

In general, the amendments establish a more streamlined and flexible election process, conform the By-Laws text with current practice, and allow the Secretary of NASD to play a more centralized role in the election process. For example, the amendments provide that the Secretary of NASD Regulation perform many of the notification and other communication functions currently performed by other parties, such as notifying NASD members of upcoming elections, requesting submission of candidates, notifying NASD members of the candidates nominated by the District Nominating Committee, notifying NASD members in the event of a contested election, and notifying the Board of election results.

## Effective Date

The rule amendments become effective on January 1, 2004.

## Endnotes

1 See Securities Exchange Act Release No. 48015 (June 11, 2003), 68 FR 35926 (June 17, 2003) (Notice of Filing and Immediate Effectiveness of File No. SR-NASD-2003-55 (Amendment No. 3 filed on June 6, 2003)).

2 See Securities Exchange Act Release No. 48259 (July 30, 2003), 68 FR 46673 (August 6, 2003) (Notice of Filing and Immediate Effectiveness of File No. SR-NASD-2003-107 (Amendment No. 3 filed on June 6, 2003)).

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

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### ARTICLE VIII

#### DISTRICT COMMITTEES AND DISTRICT NOMINATING COMMITTEES

##### Establishment of Districts

**Sec. 8.1** The Board shall establish boundaries for districts within the United States to assist NASD Regulation in administering its affairs in a manner that is consistent with applicable law, the Restated Certificate of Incorporation, these By-Laws, the Delegation Plan, and the Rules of the Association. The Board may make changes from time to time in the number or boundaries of the districts as it deems necessary or appropriate. The Board shall prescribe such policies and procedures as are necessary or appropriate to address the implementation of a new district configuration in the event of a change in the number or boundaries of the districts.

##### Composition of District Committees

**Sec. 8.2** (a) A district created under Section 8.1 shall elect a District Committee pursuant to this Article. A District Committee shall consist of no fewer than five and no more than 20 members, unless otherwise provided by resolution of the Board. Subject to the limitation set forth in the immediately preceding sentence, the authorized number of members of a District Committee shall be determined from time to time by the Board; provided, however, that no decrease in the authorized number of members of a District Committee shall shorten the term of office of any member thereof. Each District Committee member shall: (1) be employed [in the office of] by an NASD member eligible to vote in the district for District Committee elections, and (2) work primarily from such NASD member's principal office or a branch office that is located within the district where the member serves on a District Committee. [A District Committee shall determine the number of its members to be elected each year.] Members of the District Committees shall serve as panelists in disciplinary proceedings in accordance with the Rules of the Association. The District Committees shall consider and recommend policies and rule changes to the Board. The District Committees shall endeavor[, in such manner as they deem appropriate,] to educate NASD members and other brokers and dealers in their respective districts as to the objects, purposes, and work of the NASD[, and NASD Regulation[, and Nasdaq] in order to foster NASD members' interest and cooperation.

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(b) A member of a District Committee may resign at any time upon giving Notice to the District Director. Any such resignation shall take effect upon receipt of such Notice or at any later time specified therein, provided that notice of resignation at a later date may be made immediately effective at the discretion of the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s). The acceptance of such resignation shall not be necessary to make such resignation effective.

(c) [(b)] In the event of the refusal, failure, neglect, or inability of a member of a District Committee to discharge his or her duties, or for any cause affecting the best interests of NASD Regulation, the sufficiency of which shall be decided by the District Committee, the District Committee may remove the member by the affirmative vote of two-thirds of the members of the District Committee then in office and declare the member's position vacant. The District Committee shall notify the District Committee member of his or her removal within seven days after the vote. [The member's position shall be filled pursuant to Section 8.4.]A member who is removed may submit a written appeal of the removal to the Board within 30 days after the date he or she is notified of the removal. The Board may affirm, reverse, or modify the determination of the District Committee. A vote of a majority of the Directors then in office shall be required to reverse or modify the action of the District Committee.

(d) In the event of a vacancy in a District Committee resulting from death, resignation, removal, or other cause, the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) shall determine whether such vacancy shall be filled prior to the next regularly scheduled election of District Committee members. In the event the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines that a vacancy on a District Committee should be filled, the vacancy shall be filled pursuant to Section 8.4.

#### **Term of Office of District Committee Members**

**Sec. 8.3** Each regularly elected member of a District Committee shall hold office for a "full term" [of three years] which is the later of three years or until a successor is elected and qualified. Notwithstanding the term of office for a regularly elected member, such member's term shall terminate sooner upon the member's [ , or until]death, resignation, or removal. [A member of a District Committee may not serve more than two consecutive terms.]There is no limit on the number of terms that may be served by a member of a District Committee, provided, that no more than two terms may be served consecutively. The word "term" as used for the purpose of this Section shall mean either a full term for a regularly elected member or a "partial term" which is a term served by a member appointed to fill a vacancy on the District Committee created by the termination of a regularly elected member's office prior to the expiration of the full term.

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### Filling of Vacancies on District Committees

**Sec. 8.4** In the event of a vacancy on a District Committee [caused by the departure of a Committee member] prior to the expiration of the member's term of office, and where the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines, pursuant to Section 8.2(d), that such vacancy should be filled, or in the event of a newly created membership on a District Committee by virtue of an increase in the authorized number of members thereof, the District Committee shall appoint by majority vote a representative of an NASD member eligible pursuant to Section 8.2(a) [to vote in the district ]to fill the vacancy or newly created membership. The appointment by the District Committee shall be effective until the next regularly scheduled election [occurs], and until such member's successor is elected and qualified. Following the next regularly scheduled election, in the event of a vacancy, the newly elected Committee member shall serve only the duration of the departed Committee member's term, and in the event of a newly created membership, the newly elected Committee member shall serve only the duration of the term for such class of membership.

### Meetings of District Committees

**Sec. 8.5** Meetings of a District Committee shall be held at such times and places, upon such notice, and in accordance with such procedures as [each District Committee] the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) in [its] his or her discretion may determine in consultation with the Chair of the District Committee. A quorum of a District Committee shall consist of a majority of its members, and any action taken by a majority present at any meeting at which a quorum is present, except as otherwise provided in these By-Laws, shall constitute the action of the Committee. Any or all members of a District Committee may participate in any such meeting by means of conference telephone or other communications equipment by means of which all participants can communicate with each other, and such participation shall constitute presence in person at the meeting. Action by a District Committee may be taken by consent in writing or by electronic transmission in lieu of a meeting [mail, telephonic, or telegraphic vote], in which case any action taken by a majority of the Committee shall constitute the action of the Committee. [Any action taken by telephonic vote shall be confirmed in writing at a regular meeting of the District Committee.]

### Election of District Officers

**Sec. 8.6** At or following its last regularly scheduled meeting of the calendar year, [Following the annual election of members of the District Committees pursuant to this Article] each District Committee shall elect from its members a Chair and such other officers as it deems necessary for the proper performance of its duties under these By-Laws[, and shall prescribe their powers and duties].

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## Advisory Council

**Sec. 8.7** (a) The Chairs of the District Committees, elected pursuant to Section 8.6, together with the Chair of the Market Regulation Committee shall constitute an Advisory Council to the Board.

(b) The Advisory Council shall be advised of and entitled to attend such meetings of the Board as the Board may designate for such Advisory Council's attendance, and the Board shall designate at least one such meeting annually. The Advisory Council shall not be entitled to vote at meetings of the Board.

## Expenses of District Committees

**Sec. 8.8** Funds to meet the regular expenses of each District Committee shall be provided by the Board, and all such expenses shall be subject to the approval of the Board.

## Composition of District Nominating Committees

**Sec. 8.9** (a) Each district created under Section 8.1 shall elect a District Nominating Committee pursuant to this Article. A District Nominating Committee shall consist of five members, unless the Board by resolution increases a District Nominating Committee to a larger number. Each District Nominating Committee member [of a District Nominating Committee] shall: (1) be employed [in the office of] by an NASD member eligible to vote in the district for District Committee elections, and (2) work primarily from such NASD member's principal office or a branch office that is located within the district where the member serves on a District Nominating Committee, but shall not be a member of the District Committee. A majority of the members of the District Nominating Committee shall include [a majority of] persons who previously have served on a District Committee or who are current or former Directors or current or former Governors of the NASD Board[, and shall include at least one current or former Director or Governor].

(b) A member of a District Nominating Committee may resign at any time upon giving Notice to the District Director. Any such resignation shall take effect upon receipt of such Notice or at any later time specified therein, provided that notice of resignation at a later date may be made immediately effective at the discretion of the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s). The acceptance of such resignation shall not be necessary to make such resignation effective.

(c) [(b)] In the event of the refusal, failure, neglect, or inability of a member of a District Nominating Committee to discharge his or her duties, or for any cause affecting the best interests of NASD Regulation, the sufficiency of which shall be decided by the District Nominating Committee, the District Nominating Committee may remove the member by the affirmative vote of two-thirds of the members of the District Nominating Committee then in office and declare the member's position vacant. [The member's position shall be filled pursuant to Section 8.11.] The District Nominating Committee shall notify the District

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Nominating Committee member of his or her removal within seven days after the vote. A member who is removed may submit a written appeal of the removal to the Board within 30 days after the date he or she is notified in writing of the removal. The Board may affirm, reverse, or modify the determination of the District Nominating Committee. A vote of a majority of the Directors then in office shall be required to reverse or modify the action of the District Nominating Committee.

(d) In the event of a vacancy in a District Nominating Committee resulting from death, resignation, removal, or other cause, the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) shall determine whether such vacancy shall be filled prior to the next regularly scheduled election of District Nominating Committee members. In the event the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines that a vacancy on a District Nominating Committee should be filled, the vacancy shall be filled pursuant to Section 8.11.

#### **Term of Office of District Nominating Committee Members**

**Sec. 8.10** Each regularly elected member of a District Nominating Committee shall hold office for a “full term” [of one year] which is the later of one year [and] or until a successor is elected and qualified. Notwithstanding the term of office for a regularly elected member, such member’s term shall terminate sooner upon the member’s [, or until] death, resignation, or removal. [A member of a District Nominating Committee may not serve more than two consecutive terms.] There is no limit on the number of terms that may be served by a member of a District Nominating Committee, provided, that no more than two terms may be served consecutively. The word “term” as used for the purpose of this Section shall mean either a full term for a regularly elected member or a “partial term” which is a term served by a member appointed to fill a vacancy on the District Nominating Committee created by the termination of a regularly elected member’s office prior to the expiration of the full term.

#### **Filling of Vacancies for District Nominating Committees**

**Sec. 8.11** In the event of a vacancy on a District Nominating Committee [caused by the departure of a Committee member] prior to the expiration of the member’s term of office, and where the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) determines, pursuant to Section 8.9(d), that such vacancy should be filled, or in the event of a newly created membership on a District Nominating Committee by virtue of an increase in the authorized number of members thereof, the District Nominating Committee shall appoint by majority vote a representative of an NASD member eligible pursuant to Section 8.9(a) [to vote in the district] to fill the vacancy or newly created membership. The appointment shall be effective until the next regularly scheduled election [occurs] pursuant to this Article, and until such member’s successor is elected and qualified.

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### Meetings of District Nominating Committees

**Sec. 8.12** Meetings of a District Nominating Committee shall be held at such times and places, upon such notice, and in accordance with such procedures as [each District Nominating Committee] the Executive Vice President, Regulatory Policy and Programs or the Executive Vice President, Member Regulation or their respective designee(s) in [its] his or her discretion may determine in consultation with the Chair of the District Nominating Committee. A quorum of a District Nominating Committee shall consist of a majority of its members, and any action taken by a majority [of the entire Committee]present at any meeting at which a quorum is present, except as otherwise provided in these By-Laws, shall constitute the action of the District Nominating Committee. Any or all members of a District Nominating Committee may participate in any such meeting by means of conference telephone or other communications equipment by means of which all participants can communicate with each other, and such participation shall constitute presence in person at the meeting. Action by a District Nominating Committee may be taken by consent in writing or by electronic transmission in lieu of a meeting [mail, telephonic, or telegraphic vote], in which case any action taken by a majority of the District Nominating Committee shall constitute the action of the District Nominating Committee. [Action taken by telephonic vote shall be confirmed in writing at a regular meeting of the District Committee].[]

### Election of District Nominating Committee Officers

**Sec. 8.13** Following the annual election of members of the District Nominating Committees pursuant to this Article, each District Nominating Committee shall elect from its members a Chair and such other officers as it deems necessary for the proper performance of its duties under these By-Laws[, and shall prescribe their powers and duties].

### Expenses of District Nominating Committees

**Sec. 8.14** Funds to meet the regular expenses of each District Nominating Committee shall be provided by the Board, and all such expenses shall be subject to the approval of the Board.

### Notice to [Chair] District Nominating Committee

**Sec. 8.15** On or before [May 1]June 1 of each year, the Secretary of NASD Regulation shall give a Notice [send a written notice] to [the Chair of] each District Nominating Committee member and each District Director [and each District Committee] identifying the members of the District Nominating Committee and the District Committee whose terms of office shall expire in the next calendar year. The Notice [notice] shall describe election procedures for filling the offices.

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### **Solicitation of Candidates and Secretary's Notice to NASD Members**

**Sec. 8.16** The Secretary of NASD Regulation shall give a Notice of the upcoming election to NASD members and the Executive Representatives of NASD members describing the election procedures and stating that NASD members may submit names of candidates for consideration to the District Director. NASD Regulation staff shall provide the District Nominating Committee with a description of the NASD membership in the district. The District Nominating Committee shall identify and solicit candidates to nominate for election to [the vacancies on] the District Committee and the District Nominating Committee. [The District Nominating Committee Chair shall send a written notice of the upcoming election to the Executive Representative and each branch office of the NASD members in the district and request that such NASD members submit names of candidates to the District Nominating Committee or the District Director for consideration.]

#### **[Secretary's Notice to NASD Members]**

[**Sec. 8.17** The Secretary of NASD Regulation shall send a written notice to NASD members in the district describing the election procedures.]

#### **District Nominating Committee Slate**

**Sec. 8.17** [Sec. 8.18] (a) The District Nominating Committee shall review the background of proposed candidates and the description of the NASD membership provided by NASD Regulation staff and shall nominate a slate of candidates for the election. The slate shall include one [or more] candidate[s] for each position on the District Committee and the District Nominating Committee subject to election at the next annual election [vacancy]. In nominating candidates for the office of member of the District Committee and the office of member of the District Nominating Committee, the District Nominating Committee shall endeavor to secure appropriate and fair representation on the District Committee and on the District Nominating Committee of the various sections of the district and [all] various classes and types of NASD members engaged in the investment banking or securities business within the district. In nominating candidates for the office of member of the District Nominating Committee, a District Nominating Committee shall assure that the composition of the District Nominating Committee meets the standards in Section 8.9(a).

(b) A District Nominating Committee shall not nominate an incumbent member of the District Committee to succeed himself or herself on the District Committee [unless the District Nominating Committee first takes appropriate action by a written ballot of the entire NASD membership within the district to ascertain that such nomination is acceptable to a majority of the NASD members in the district,] unless the incumbent member of the District Committee is serving pursuant to the provisions of Section 8.4 or is serving a term pursuant to the provisions of Section 8.2 and reelection would not cause the incumbent member to violate the provisions of Section 8.3. A District Nominating Committee may not nominate more than two incumbent members of the District Nominating Committee to succeed themselves.

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### [Certification] Notification of Nomination

**Sec. 8.18** [Sec. 8.19] The District Director, acting on behalf of the District Nominating Committee, shall give a Notice to the Secretary of NASD Regulation of [certify to the District Committee] each candidate nominated by the District Nominating Committee and the office to which the candidate is nominated. [Within five calendar days after the certification, the District Committee shall send to the Executive Representatives of NASD members in the district a copy of the certification.] On or before October 1 of each year, the Secretary of NASD Regulation shall give a Notice of the nominated candidates to the Executive Representatives of NASD members and the District Committee.

### Uncontested Election

**Sec. 8.19** If the District Nominating Committee nominates one candidate for each position on the District Committee and the District Nominating Committee subject to election at the next annual election and no additional candidate is nominated pursuant to Section 8.22, the candidates nominated by the District Nominating Committee shall be considered duly elected.

### Designation of Additional Candidates

**Sec. 8.20** If an officer, director, or employee of an NASD member who meets the qualifications of Section 8.2 or 8.9, as applicable, is not nominated by the District Nominating Committee and wants to be considered for election to [a vacancy on] the District Committee or the District Nominating Committee, he or she shall deliver [send] a written notice to the District Director within 14 calendar days after the Secretary of NASD Regulation gives the Notice of nominated candidates [the mailing date of the certification to the Executive Representatives] pursuant to Section 8.18[9]. The District Director shall make a written record of the time and date of the receipt of the officer's, director's, or employee's notice. The officer, director, or employee shall be designated as an "additional candidate."

### List of NASD Members Eligible to Vote

**Sec. 8.21** (a) The Secretary of NASD Regulation shall provide a list of all NASD members eligible to vote in the district, their mailing addresses, and their Executive Representatives to the additional candidate promptly [immediately] following receipt of the additional candidate's timely notice by the District Director.

(b) An NASD member that has its principal office[, ] and/or one or more registered branch offices[, or its principal office and one or more registered branch offices] in the district shall be eligible to cast one vote through the NASD member's Executive Representative for each position on the District Committee and the District Nominating Committee [vacancy] to be filled in the election.

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### Requirement for Petition Supporting Additional Candidate

**Sec. 8.22** An additional candidate shall be nominated if a petition signed by at least ten percent of the NASD members eligible to vote in the district is filed with the District Nominating Committee within 30 calendar days after the date of the mailing of the list to the additional candidate pursuant to Section 8.21. Only an Executive Representative may sign a petition on behalf of an NASD member.

#### [Uncontested Election]

[**Sec. 8.23** If the District Nominating Committee nominates one candidate for each vacancy and no additional candidate is nominated pursuant to Section 8.22, the candidates nominated by the District Nominating Committee shall be considered duly elected and the District Committee shall certify the election to the Board.]

#### Notice of Contested Election

**Sec. 8.23** [Sec. 8.24] If [the District Nominating Committee nominates more than one candidate for vacancy, or if] an additional candidate is nominated pursuant to Section 8.22, the election shall be considered a contested election. The Secretary of NASD Regulation shall give a Notice [District Committee shall send a notice] to the Executive Representatives of the NASD members eligible to vote in the district announcing the names of the candidates and the office to which each candidate is nominated and describing contested election procedures.

#### Administrative Support

**Sec. 8.24** [Sec. 8.25] The District Office shall provide administrative support to all candidates by sending, by electronic transmission, to NASD members eligible to vote in the district up to two distributions [mailings] of materials prepared by the candidates. [NASD Regulation shall pay the postage for the mailings.] If a candidate wants such distributions [mailings] sent, the candidate shall prepare such material on the candidate's personal stationery and make the material available to NASD Regulation in electronic format. The material shall state that it represents the opinion of the candidate. [The candidate shall provide a copy of the material for each member of the NASD in the district.] Candidates nominated by the District Nominating Committee may identify themselves as such in their materials. Any candidate also may send [additional] mailings at the candidate's own expense. Except as provided in this Article, NASD Regulation, the Board, the Regional Nominating Committee, any other committee, and NASD Regulation staff shall not provide any other administrative support to a candidate in the election.

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## Ballots

**Sec. 8.25** [Sec. 8.26] With the assistance of the Secretary of NASD Regulation and an Independent Agent, the District Nominating Committee shall prepare a ballot with the names of the District Nominating Committee's candidates and any additional candidate nominated pursuant to Section 8.22 and the office to which each candidate is nominated. The ballot shall list separately, in alphabetical order, the candidates [in alphabetical order and shall identify the candidates] nominated by the District Nominating Committee and the additional candidates nominated pursuant to Section 8.22. The Secretary of NASD Regulation [District Nominating Committee] shall send a ballot to the Executive Representative of each NASD member eligible to vote in the district. Instructions on the ballot shall direct the Executive Representative to return the ballot to the Independent Agent and state that the ballot envelope must be postmarked on or before the return date specified on the ballot. The return date specified on the ballot shall be no fewer than ~~[30]~~20 and no more than ~~[45]~~30 days after the date of mailing of the ballot.

## Vote Qualification List

**Sec. 8.26** [Sec. 8.27] Eligibility to vote in a district election shall be based on the NASD's membership records as of a date selected by the Secretary of NASD Regulation that is not more than 30 days before the date of mailing of the ballot. The Secretary of NASD Regulation shall prepare a list of NASD members eligible to vote in the district, their mailing addresses, and their Executive Representatives, which shall be used for vote qualification purposes, and shall provide the list to the candidates.

## Ballots Returned as Undelivered

**Sec. 8.27** [Sec. 8.28] The Independent Agent shall open any ballot envelope returned undelivered and shall determine whether it was sent to the NASD member's address of record. If incorrectly addressed, the Independent Agent shall send a new ballot to the address of record.

## General Procedures for Qualification and Accounting of Ballots

**Sec. 8.28** [Sec. 8.29] After the voting period, on a date or dates designated by the Secretary of NASD Regulation, the qualification and accounting of ballots shall take place. The date or dates designated shall be not later than 14 calendar days after the return date specified on the ballot pursuant to Section 8.25[6]. Candidates and their representatives shall be allowed to observe the qualification and accounting of ballots. Representation for each candidate shall be limited to two individuals. The Independent Agent shall bring to [the district office] a location within the district agreed to between the Independent Agent and the Secretary of NASD Regulation all ballots timely received. Under the direction of the Secretary of NASD Regulation or the Secretary's designee, the Independent Agent shall open and count the ballots. For ballot qualification purposes, the Independent Agent shall identify to the candidates the NASD members that timely returned ballots and inform the candidates of the Independent Agent's determination of whether or not a ballot is qualified for voting purposes.

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The determination shall be based on a comparison of ballots received against the list of NASD members eligible to vote in the district and their Executive Representatives as prepared by the Secretary of NASD Regulation pursuant to Section 8.26[7]. The Secretary of NASD Regulation or the Secretary's designee shall make the final determination of the qualification of a ballot. Upon the qualification of a ballot, the Independent Agent shall record the vote indicated on the ballot. The candidates and their representatives shall not be allowed to see the vote of an NASD member.

### Ballots Set Aside

**Sec. 8.29** [Sec. 8.30] The Independent Agent shall set aside a ballot if: (a) the ballot is received from an NASD member eligible to vote in the district and the ballot is signed by a person who is not the Executive Representative listed on the vote qualification list prepared under Section 8.26[7], and the Secretary of the NASD has not received proper notice of a change in Executive Representative pursuant to the NASD By-Laws; or (b) if two or more properly executed ballots are received from an NASD member eligible to vote in the district. If the Independent Agent determines that the ballots set aside are material to the outcome of the election, the Secretary of NASD Regulation and the Independent Agent shall make reasonable efforts to resolve each ballot set aside. With respect to a ballot not signed by an Executive Representative of record, the Secretary of NASD Regulation shall contact the NASD member to request that the NASD member send written notice of any change in Executive Representative by facsimile so that the ballot may be counted. With respect to multiple ballots from an NASD member, the Independent Agent shall contact the Executive Representative of the NASD member to obtain the NASD member's vote. The Secretary of NASD Regulation shall keep a list of NASD members that reported their ballot was lost or not received and that were provided with a duplicate ballot. The Secretary of NASD Regulation shall provide the list to the Independent Agent and, upon request, to the candidates.

### Invalid Ballots

**Sec. 8.30** [Sec. 8.31] The Independent Agent shall declare a ballot invalid if one or more of the following conditions exist:

- (a) the ballot is not signed by the Executive Representative (unless Section 8.29[30] applies);
- (b) a vote is not indicated on the ballot; or
- (c) the ballot indicates votes for more candidates than there are positions on the District Committee or District Nominating Committee subject to election in the election [vacancies for an office].

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### [Certification of] Election Results

**Sec. 8.31** [Sec. 8.32] Under the direction of the Secretary of NASD Regulation or the Secretary's designee, the Independent Agent shall count the votes received for each candidate in a district. The candidates for the office of member of the District Committee or District Nominating Committee receiving the largest number of votes cast in the district for the office shall be declared elected such that the number of candidates declared elected equals the number of positions [vacancies] on the District Committee or District Nominating Committee subject to election in the election. [The candidates for the office of member of the District Nominating Committee receiving the largest number of votes cast in the district for the office shall be declared elected such that the number of candidates declared elected equals the number of vacancies on the District Nominating Committee.] In the event of a tie, there shall be a run-off election. The Secretary of NASD Regulation shall notify the Board of the election results. [Each District Committee shall send a written certification of the election results to the Board.] The notification [certification] shall state the number of votes received by each candidate and the number of ballots set aside.

### Extensions of Time and Additional Procedures

**Sec. 8.32** [Sec. 8.33] The Secretary of NASD Regulation may extend a time period under this Article for good cause shown. In extraordinary circumstances, the Secretary of NASD Regulation, with the approval of the Executive Committee or the Board, may adopt additional procedures for elections under this Article.

### Definitions

**Sec. 8.33** (a) When used in Article VIII of these By-Laws, the term "Notice" means a notice in writing or by electronic transmission and the term "electronic transmission" means any form of communication, not directly involving the physical transmission of paper, that creates a record that may be retained, retrieved and reviewed by a recipient thereof, and that may be directly reproduced in paper form by such a recipient through an automated process.

(b) For purposes of this Article VIII, any notice by NASD Regulation, the Secretary of NASD Regulation, or the District Director given by electronic transmission shall be deemed given: (1) if by facsimile telecommunication, when directed to a number at which the person entitled to notice has consented to receive notice; (2) if by electronic mail, when directed to an electronic mail address at which the person entitled to notice has consented to receive notice; (3) if by a posting on an electronic network when the person entitled to notice has consented to receive notice in this manner, together with separate notice to the person entitled to notice of such specific posting, upon the later of (A) such posting and (B) the giving of such separate notice; and (4) if by any other form of electronic transmission when the person entitled to notice has consented to receive notice in this manner, when directed to the person entitled to notice. For purposes of this Article VIII, if mailed, any such notice by NASD Regulation, the Secretary of NASD Regulation, or the District Director shall be deemed given when deposited in the United States mail, postage prepaid, directed to the person entitled to notice at such person's address as it appears on the records of NASD Regulation.

# Special Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registration  
Senior Management

## KEY TOPICS

District Elections

INFORMATIONAL

## District Elections

Nominees for District Committee and District Nominating Committee

### Executive Summary

The purpose of this *Special Notice to Members* is to announce the nominees for the District Committees and the District Nominating Committees. The individuals identified in this *Special Notice to Members* (see Attachment A) have been nominated for three-year terms<sup>1</sup> on the District Committees and for one-year terms on the District Nominating Committees starting in January 2004. These nominees will be considered duly elected on **October 1, 2003**, unless an election is contested in accordance with the procedures summarized below.

We appreciate the interest shown by many of you in participating in the District Committees and thank everyone for their continuing support of the self-regulatory process. We look forward to your participation in the matters of the Districts during the coming year, as well as hope that those who were not selected this year may wish to revisit this process next year.

### Contested Election Procedures

If an officer, director, or employee of a NASD member is interested in being considered as an additional candidate, he/she must indicate his/her interest to the District Director, or the Corporate Secretary, Barbara Z. Sweeney, by **October 1, 2003**. If an additional candidate(s) comes forward by that date, the candidate has until **October 31, 2003**, to submit a petition to the District Nominating Committee with signatures from at least 10 percent of Executive Representatives of members eligible to vote in the District.

03-52

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If no additional candidates submit petitions by **October 31, 2003**, then the candidates nominated by the District Nominating Committee shall be considered elected as of **October 1, 2003**, and the District Committee shall certify the election to the Board of Directors of NASD Regulation.

Additional information pertaining to the District Election Procedures can be found in Article VIII of the By-Laws of NASD Regulation.

### Questions/Further Information

Questions concerning this *Special Notice* may be directed to the District Director noted in Attachment A or to Barbara Z. Sweeney, Senior Vice President and Corporate Secretary, NASD, at (202) 728-8062 or via e-mail at: [barbara.sweeney@nasd.com](mailto:barbara.sweeney@nasd.com).

### Endnote

- 1 Some nominees are filling existing vacancies and therefore may serve less than a three-year term, as indicated on Attachment A.

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## ATTACHMENT A

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### District Committee and District Nominating Committee Nominees

#### District 1

**Elisabeth P. Owens**, District Director

525 Market Street, Suite 300, San Francisco, CA 94105-2711

(415) 882-1200

*Northern California (the counties of Monterey, San Benito, Fresno, and Inyo, and the remainder of the state north or west of such counties), northern Nevada (the counties of Esmeralda and Nye, and the remainder of the state north or west of such counties), and Hawaii*

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#### 2003 District Nominating Committee Chair

Glenn M. Colacurci	Salomon Smith Barney	San Francisco, CA
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#### District 1 Nominees

William A. Evans	Stone & Youngberg LLC	San Francisco, CA
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Mansoor Kijat	Citigroup Global Markets, Inc.	Santa Rosa, CA
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Arthur E. Raitano	Hoefer & Arnett, Incorporated	San Francisco, CA
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#### District 1 Nominating Committee Nominees

Stephen R. Adams	Wells Fargo Investments, LLC	San Francisco, CA
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Sally G. Aelion	Emmett A. Larkin Company, Inc.	San Francisco, CA
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Robert S. Basso	Correspondent Services Corporation	San Francisco, CA
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James D. Klein	UBS PaineWebber, Inc.	San Francisco, CA
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L. Robert McKulla	Prudential Division of Wachovia Securities, LLC	Walnut Creek, CA
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## District Committee And District Nominating Committee Nominees

### District 2

**Lani M. Sen Woltmann**, District Director

300 South Grand Avenue, Suite 1600, Los Angeles, CA 90071

(213) 627-2122

*Southern California (that part of the state south or east of the counties of Monterey, San Benito, Fresno, and Inyo), southern Nevada (that part of the state south or east of the counties of Esmeralda and Nye), and the former U.S. Trust Territories*

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### 2003 District Nominating Committee Chair

Robert L. Winston	American Funds Distributors, Inc.	Los Angeles, CA
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### District 2 Nominees

Stephen B. Benton	Financial Network Investment Corp.	Torrance, CA
James M. S. Dillahunty	Fixed Income Securities, LLC	San Diego, CA
John D. Lewis	JDL Securities Corp.	Newport Beach, CA

### District 2 Nominating Committee Nominees

James E. Biddle	The Securities Center Incorporated	Chula Vista, CA
Margaret M. Black	Morgan Stanley Dean Witter	Los Angeles, CA
Diane P. Blakeslee	Blakeslee & Blakeslee, Inc.	San Luis Obispo, CA
Miles Z. Gordon		Indian Wells, CA
Steven K. McGinnis	Keystone Capital Corporation	San Diego, CA

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## District Committee And District Nominating Committee Nominees

### District 3

**Joseph M. McCarthy**, District Director

370 17th Street, Suite 2900, Denver, CO 80202-5629

(303) 446-3100

*Arizona, Colorado, New Mexico, Utah, and Wyoming*

**James G. Dawson**, District Director

Two Union Square, 601 Union Street, Suite 1616, Seattle, WA 98101-2327

(206) 624-0790

*Alaska, Idaho, Montana, Oregon, and Washington*

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### 2003 District Nominating Committee Chair

Martin O. Nelson                      Martin Nelson & Co., Inc.                      Seattle, WA

### District 3 Nominees

Curtis J. Hammond	Morgan Stanley Dean Witter, Inc.	Bellevue, WA
J. Keith Kessel	AFS Brokerage, Inc.	Greenwood Village, CO
Arlene M. Wilson	D.A. Davidson & Co.	Great Falls, MT

### District 3 Nominating Committee Nominees

Elyssa S. Baltazar	Morgan Stanley Dean Witter, Inc.	Denver, CO
L. Hoyt DeMers	Wells Fargo Investments, LLC	Seattle, WA
Steven Larson	Richards Merrill & Peterson Inc.	Spokane, WA
Anthony B. Petrelli	Neidiger, Tucker, Bruner, Inc.	Denver, CO
Kathryn A. Supko	Northwestern Mutual Investment Services, LLC	Boise, ID

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## District Committee And District Nominating Committee Nominees

### District 4

**Thomas D. Clough**, District Director

120 West 12th Street, Suite 900, Kansas City, MO 64105

(816) 421-5700

*Iowa, Kansas, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota*

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### 2003 District Nominating Committee Chair

Norman Frager	Flagstone Securities, LLC	St. Louis, MO
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### District 4 Nominees

Michael D. Burns (2-Year Term)	USAllianz Securities, Inc.	Minneapolis, MN
Joseph D. Fleming	U.S. Bancorp Piper Jaffray, Inc.	Minneapolis, MN
Richard M. Hurwitz	Benefit Finance Securities, LLC	St. Louis, MO
Mark T. Lasswell	Wells Fargo Brokerage Services, LLC	Minneapolis, MN
Kevin P. Maas (2-Year Term)	PrimeVest Financial Services, Inc.	St. Cloud, MN

### District 4 Nominating Committee Nominees

Gene M. Diederich	A.G. Edwards & Sons, Inc.	Overland Park, KS
Timothy J. Lyle	Trusted Securities Advisors Corp.	Minneapolis, MN
E. John Moloney	Moloney Securities Co., Inc.	St. Louis, MO
L.C. (Jack) Petersen	Kirkpatrick, Pettis, Smith, Polian, Inc.	Omaha, NE
Pamela R. Ziermann	Dougherty & Company, LLC	Minneapolis, MN

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## District Committee And District Nominating Committee Nominees

### District 5

**Warren A. Butler, Jr.,** District Director

1100 Poydras Street, Energy Centre, Suite 850, New Orleans, LA 70163-0802  
(504) 522-6527

*Alabama, Arkansas, Louisiana, Mississippi, Oklahoma, and Tennessee*

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### 2003 District Nominating Committee Chair

Duncan F. Williams	Duncan-Williams, Inc.	Memphis, TN
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### District 5 Nominees

Jennifer Carty Scola	Carty & Company, Inc.	Memphis, TN
R. Patrick Shepherd	Avondale Partners, L.L.C.	Nashville, TN
Donald R. Winton	Crews & Associates, Inc.	Little Rock, AR

### District 5 Nominating Committee Nominees

David A. Daugherty	James Baker & Associates	Oklahoma City, OK
James S. Holbrook, Jr.	Sterne, Agee & Leach, Inc.	Birmingham, AL
E. Douglas Johnson, Jr.	Johnson Rice & Company L.L.C.	New Orleans, LA
Tom R. Steele	Equitable Advisors, Inc.	Nashville, TN
Duncan F. Williams	Duncan-Williams, Inc.	Memphis, TN

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## District Committee And District Nominating Committee Nominees

### District 6

**Virginia F. M. Jans**, District Director

12801 N. Central Expressway, Suite 1050, Dallas, TX 75243

(972) 701-8554

Texas

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### 2003 District Nominating Committee Chair

Fredrick W. McGinnis	UBS PaineWebber, Inc.	Houston, TX
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### District 6 Nominees

Karen Banks	Frost Brokerage Services, Inc.	San Antonio, TX
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Cynthia E. Besek	Maplewood Investment Advisors, Inc.	Dallas, TX
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Darryl W. Traweek	RBC Dain Rauscher Inc.	Houston, TX
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### District 6 Nominating Committee Nominees

Christopher R. Allison	M.E. Allison & Co., Inc.	San Antonio, TX
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C. Ronald Baker	The (Wilson) Williams Financial Group	Lubbock, TX
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William B. Madden	Madden Securities Corporation	Dallas, TX
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Edward M. Milkie	Milkie/Ferguson Investments, Inc.	Dallas, TX
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David W. Turner	Wachovia Securities, Inc.	Fort Worth, TX
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## District Committee And District Nominating Committee Nominees

### District 7

**Alan M. Wolper**, District Director

One Securities Centre, Suite 500, 3490 Piedmont Road, NE, Atlanta, GA 30305  
(404) 239-6100

*Florida, Georgia, North Carolina, South Carolina, Puerto Rico, the Canal Zone, and the Virgin Islands*

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### 2003 District Nominating Committee Chair

Edward R. Hipp, III	Legg Mason Wood Walker, Inc.	Norfolk, VA
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### District 7 Nominees

Susan J. Hechtlinger	Banc of America Investment Services, Inc.	Charlotte, NC
Landrum H. Henderson, Jr.	Legg Mason Wood Walker, Inc.	Charlotte, NC
Alan L. Maxwell, Jr.	Wachovia Capital Markets, LLC	Charlotte, NC
Mr. Roark A. Young (One-Year Term)	Young, Stovall and Company	Miami, FL

### District 7 Nominating Committee Nominees

Michael D. Hearn, Esq.	Banc of America Investment Services, Inc.	Charlotte, NC
Kenneth W. McGrath	Popular Securities, Inc.	Hato Rey, PR
C. John O'Bryant, III	PowellJohnson, Private Asset Management	Raleigh, NC
Glenn R. Oxner	Scott & Stringfellow, Inc.	Greenville, SC
John W. Waechter	William R. Hough & Co.	St. Petersburg, FL

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## District Committee And District Nominating Committee Nominees

### District 8

**Carlotta A. Romano**, District Director

55 West Monroe Street, Suite 2700, Chicago, IL 60603-5051

(312) 899-4400

*Illinois, Indiana, Kentucky, Michigan, and Wisconsin*

**William H. Jackson, Jr.**, District Director

Renaissance on Playhouse Square, 1350 Euclid Avenue, Suite 650, Cleveland, OH 44115

(216) 592-2950

*Ohio*

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### 2003 District Nominating Committee Chair

Wallen L. Crane	Salomon Smith Barney	Toledo, OH
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### District 8 Nominees

Michael E. Bosway	City Securities Corporation	Indianapolis, IN
Robert J. Michelotti	Ferris, Baker Watts Incorporated	Auburn Hills, MI
Lora Rosenbaum	Northwestern Mutual Investment Services	Milwaukee, WI

### District 8 Nominating Committee Nominees

William C. Alsover, Jr.	Centennial Securities Company, Inc.	Grand Rapids, MI
Mary D. Esser	Cressman Esser Securities, Inc.	Naperville, IL
Gregory Goelzer	Goelzer Investment Management	Indianapolis, IN
Rodney Trautvetter	Harris Investor Services, LLC	Chicago, IL
Bruce J. Young	Mesirow Financial, Inc.	Chicago, IL

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## District Committee And District Nominating Committee Nominees

### District 9

**Gary K. Liebowitz**, District Director

581 Main Street, 7th Floor, Woodbridge, NJ 07905

(732) 596-2000

*New Jersey and New York (except for the Counties of Nassau, Orange, Putnam, Rockland, Suffolk, Westchester, and the five boroughs of New York City)*

**John P. Nocella**, District Director

Eleven Penn Center, 1835 Market Street, Suite 1900, Philadelphia, PA 19103

(215) 665-1180

*Delaware, the District of Columbia, Maryland, Pennsylvania, Virginia and West Virginia*

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### 2003 District Nominating Committee Chair

A. Louis Denton	Philadelphia Corporation for Investment Services	Philadelphia, PA
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### District 9 Nominees

John Blucher	Knight Securities, L.P.	Jersey City, NJ
Barry M. Cash	UBS Financial Services, Inc.	Fishkill, NY
Peter P. Jenkins	Credit Suisse First Boston LLC	Baltimore, MD

### District 9 Nominating Committee Nominees

J. Lee Keiger, III	Davenport & Company, LLC	Richmond, VA
John P. Meegan	Parker/Hunter Incorporated	Pittsburgh, PA
Lance A. Reihl	1717 Capital Management Company	Berwyn, PA
Howard B. Scherer	Janney Montgomery Scott LLC	Philadelphia, PA
Lenda P. Washington	GRW Capital Corporation	Washington, DC

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## District Committee And District Nominating Committee Nominees

### District 10

**Robert B. Kaplan**, Acting District Director

One Liberty Plaza, New York, NY 10006

(212) 858-4000

*The five boroughs of New York City, and Long Island*

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### 2003 District Nominating Committee Chair

Tom M. Wirtshafter	AXA Advisors, LLC	New York, NY
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### District 10 Nominees

Richard Berenger	MetLife Securities, Inc.	New York, NY
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Lon T. Dolber	American Portfolios Financial Services	Holbrook, NY
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George T. Mimura	Nomura Securities International, Inc.	New York, NY
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Howard R. Plotkin	Lehman Brothers Inc.	New York, NY
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### District 10 Nominating Committee Nominees

William Behrens	Northeast Securities, Inc.	New York, NY
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Ruth S. Goodstein	UBS Financial Services, Inc.	New York, NY
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Judith R. MacDonald	Rothschild, Inc.	New York, NY
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Charles V. Senatore	Fidelity Brokerage Services, LLC	New York, NY
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Stephen C. Strombelline	BNP Paribas Securities Corp.	New York, NY
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## District Committee And District Nominating Committee Nominees

### District 11

**Frederick F. McDonald**, District Director

260 Franklin Street, 16th Floor, Boston, MA 02110

(617) 261-0800

*Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont*

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### 2003 District Nominating Committee Chair

Stephen O. Buff	Fleet Securities, Inc.	Boston, MA
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### District 11 Nominees

David K. Booth	Jefferson Pilot Securities Corp.	Concord, NH
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Thomas F. Hollenbeck	J.P. Morgan Invest, LLC	Boston, MA
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Curtis L. Snyder, Jr.	American Technology Research, Inc.	Old Greenwich, CT
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### District 11 Nominating Committee Nominees

Richard J. DeAgazio	Boston Capital Services, Inc.	Boston, MA
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John I. Fitzgerald	Leerink Swann & Company	Boston, MA
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John D. Lane	Lane Capital Markets LLC	Fairfield, CT
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Robert V. Rodia	People's Securities, Inc.	Bridgeport, CT
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Gregory D. Teese	Equity Services, Inc.	Montpelier, VT
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# Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Rule 2710  
Rule 2810  
Non-Cash Compensation Provisions  
Rule Modernization

INFORMATIONAL

## Non-Cash Compensation

SEC Announces Immediate Effectiveness of Amendments to Non-Cash Compensation Provisions of Rule 2710 and Rule 2810

### Executive Summary

On April 7, 2003, NASD filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a proposed rule change to codify existing staff interpretations regarding the non-cash compensation provisions in Rule 2710 (Corporate Financing Rule) and Rule 2810 (Direct Participation Program or DPP Rule) and to make the rule text in such Rules consistent with the non-cash compensation provisions in Rule 2820 (Variable Contracts Rule) and Rule 2830 (Investment Company Rule).<sup>1</sup> The rule change has become effective as of April 7, 2003.

Rule 2710 and Rule 2810, as amended, are set forth in Attachment A.

Questions concerning this *Notice* may be directed to Therese M. Woods, Deputy Director, Corporate Financing Department, NASD, at (240) 386-4661; or Kosha K. Dalal, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, NASD, at (202) 728-6903.

### Background and Discussion

Since 1994, the SEC, NASD, and the securities industry have raised concerns about actual and potential conflicts of interest in the retail brokerage business created by a broad range of compensation practices whereby program sponsors or issuers provide incentives or rewards to individual broker/dealers and their registered representatives for selling the issuer's products. NASD staff believes that the use of non-cash compensation can create significant point-of-sale incentives that may compromise suitability determinations

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and heighten the potential for loss of supervisory control over sales practices. In addition, NASD staff believes that the use of non-cash compensation incentives may result in the loss of investor confidence by increasing the perception of inappropriate practices.

Responding to these concerns, in January 1999 NASD amended the Variable Contracts and Investment Company Rules to establish comprehensive restrictions on the use of non-cash compensation in connection with the sale and distribution of investment company securities and variable contracts.<sup>2</sup> These amendments generally limited the manner in which members can pay for or accept non-cash compensation and detail the types of non-cash compensation that are permissible. The amendments also provided limited exceptions to the non-cash compensation restrictions for payments or reimbursements that are in connection with training and education meetings. The 1999 amendments also defined certain key terms, such as “compensation” and “non-cash compensation.”

Since January 1999, through interpretive advice, responses to exemptive requests, and in the course of the filing review process under the Corporate Financing and DPP Rules, NASD staff has consistently applied the non-cash compensation prohibitions in the Variable Contracts and Investment Company Rules to sales of variable annuities, mutual funds, DPP securities, public offerings of debt and equity securities, and real estate investment trust (REIT) programs. Although training and education meetings were not permitted under the original non-cash compensation provisions of the Corporate Financing and DPP Rules, NASD has recognized that *bona-fide* training and education meetings that meet the strict requirements set out in the Variable Contracts and Investment Company Rules can be held consistent with the non-cash compensation prohibitions.

The amendments to the Corporate Financing and DPP Rules codify a stated policy, practice, and interpretation that the more detailed non-cash compensation provisions in the Variable Contracts and Investment Company Rules apply to the sale and distribution of securities governed by the Corporate Financing and DPP Rules. NASD is conforming the language in the Corporate Financing and DPP Rules to be consistent with the more detailed language contained in the Variable Contracts and Investment Company Rules by: (1) adopting definitions of the terms “compensation,” “non-cash compensation” and “offeror”; (2) providing express exceptions from the non-cash compensation limitations for *bona-fide* training and education meetings; and (3) prohibiting, with certain exceptions, members or persons associated with members from directly or indirectly accepting or paying any non-cash compensation in connection with public offerings of debt or equity securities, REIT programs, or DPP securities.

Consistent with the Variable Contracts and Investment Company Rules, the rule amendments provide express exceptions from the non-cash compensation provisions that would permit: (1) gifts of up to \$100 per associated person annually; (2) an occasional meal, ticket to a sporting event or theater, or comparable entertainment; (3) payment or reimbursement for training and education meetings held by broker/dealers or issuers/sponsors for the purpose of educating associated persons of broker/dealers, so long as certain conditions are met; (4) in-house sales incentive programs of

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broker/dealers for their own associated persons; and (5) contributions by any non-member company or other member to a broker/dealer's permissible in-house sales incentive program, provided there is compliance with certain criteria.

The amendments to the Corporate Financing and DPP Rules codify the application of the training and education meetings exception, and corresponding interpretive guidance, to the sale and distribution of public offerings of debt and equity securities, REIT programs, and DPPs. Currently, the Variable Contracts and Investment Company Rules contain an express exception to the non-cash compensation provisions for training and education meetings that the industry believes are necessary to educate representatives about their products. The two rules, however, contain conditions that must be satisfied before the exception can be used. Specifically, they require the following: receipt of prior approval of attendance by the associated person from his or her member firm; satisfaction of the recordkeeping requirements; that attendance at the meeting not be preconditioned on the achievement of a sales target; that the location of the meeting be appropriate and meet certain requirements;<sup>3</sup> and that no reimbursement be provided for expenses of a guest. Since the adoption of these provisions, NASD has issued strict guidelines on the appropriate use of the training and education exception through *Regulatory & Compliance Alerts*, interpretive letters, and other correspondence with members. This guidance has stated that a sponsor is not permitted to pay for certain expenses in connection with a training and education meeting, including, but not limited to, golf outings, cruises, tours, and other entertainment.

## Effective Date

The rule amendments were effective immediately upon filing with the Commission, which was April 7, 2003.

## Endnotes

- 1 See Securities Exchange Act Release No. 47697 (April 18, 2003), 68 FR 20191 (April 24, 2003) (Notice of Filing and Immediate Effectiveness of File No. SR-NASD-2003-68 (April 7, 2003)).
- 2 See Securities Exchange Act Release No. 40214 (July 15, 1998), 63 FR 39614 (July 23, 1998), File No. SR-NASD-97-35 (May 7, 1997).
3. The non-cash compensation provisions specify that the location of a training and education meeting must be appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

\* \* \* \* \*

### 2710. Corporate Financing Rule – Underwriting Terms and Arrangements

(a) through (b) No Change.

#### (c) Underwriting Compensation and Arrangements

(1) through (5) No Change.

#### (6) Unreasonable Terms and Arrangements

(A) No Change.

(B) Without limiting the foregoing, the following terms and arrangements, when proposed in connection with the distribution of a public offering of securities, shall be unfair and unreasonable:

(i) through (xii) No Change.

(xiii) [for a member or person associated with a member to accept, directly or indirectly, any non-cash sales incentive item including, but not limited to, travel bonuses, prizes and awards, from an issuer or an affiliate thereof in excess of \$100 per person per issuer annually. Notwithstanding the foregoing, a member may provide non-cash sales incentive items to its associated persons provided that no issuer, or an affiliate thereof, including specifically an affiliate of the member, directly or indirectly participates in or contributes to providing such non-cash sales incentive; or]

(xiv) – (xv) Renumbered (xiii) – (xiv).

(7) through (8) No Change.

#### (d) Non-Cash Compensation

##### (1) Definitions

The terms “compensation,” “non-cash compensation” and “offeror” as used in this Section (d) of this Rule shall have the following meanings:

(A) “Compensation” shall mean cash compensation and non-cash compensation.

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(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, an adviser to an issuer, an underwriter and any affiliated person of such entities.

## **(2) Restrictions on Non-Cash Compensation**

In connection with the sale and distribution of a public offering of securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors<sup>1</sup> and are not preconditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by subparagraph (d)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the issuer or affiliate thereof, the office of the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

<sup>1</sup> The current annual amount fixed by the Board of Governors is \$100.

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(iv) the payment or reimbursement by the issuer or affiliate of the issuer is not conditioned by the issuer or an affiliate of the issuer on the achievement of a sales target or any other non-cash compensation arrangement permitted by subparagraph (d)(2)(D).

(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in subparagraph (d)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by subparagraphs (d)(2)(C)-(E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with subparagraph (d)(2)(C)-(E).

(d) Renumbered as (e).

\* \* \* \* \*

## **2810. Direct Participation Programs**

(a) No Change.

### **(b) Requirements**

(1) through (3) No Change.

### **(4) Organization and Offering Expenses**

(A) through (D) No Change.

(E) [No member or person associated with a member shall directly or indirectly accept any non-cash compensation or sales incentive item including, but not limited to, travel bonuses, prizes, and awards offered or provided to such member or its associated persons by any sponsor, affiliate of a sponsor or program. Notwithstanding the foregoing, a member may provide non-cash compensation or sales incentive items to its associated persons provided that no sponsor, affiliate of a sponsor or program, including specifically an affiliate

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of the member, directly or indirectly participates in or contributes to providing such non-cash compensation. Further, this subparagraph shall not prohibit a person associated with a member from accepting any non-cash sales incentive item offered directly to that person by a sponsor, affiliate of a sponsor or program where:

(i) the aggregate value of all such items paid by any sponsor or affiliate of a sponsor to each associated person during any year does not exceed \$100.00;

(ii) the value of all such items to be made available in connection with an offering is included as compensation to be received in connection with the offering for purposes of subparagraph (B); and

(iii) the proposed payment or transfer of all such items is disclosed in the prospectus or similar offering document,]

(F) Renumbered to (E).

(5) through (6) No Change.

**(c) Non-Cash Compensation**

**(1) Definitions**

The terms "compensation," "non-cash compensation" and "offeror" as used in this Section (c) of this Rule shall have the following meanings:

(A) "Compensation" shall mean cash compensation and non-cash compensation.

(B) "Non-cash compensation" shall mean any form of compensation received in connection with the sale and distribution of direct participation securities that is not cash compensation, including but not limited to merchandise, gifts and prizes, travel expenses, meals and lodging.

(C) "Offeror" shall mean an issuer, sponsor, an adviser to an issuer or sponsor, an underwriter and any affiliated person of such entities.

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## (2) Restriction on Non-Cash Compensation

In connection with the sale and distribution of direct participation securities, no member or person associated with a member shall directly or indirectly accept or make payments or offers of payments of any non-cash compensation, except as provided in this provision. Non-cash compensation arrangements are limited to the following:

(A) Gifts that do not exceed an annual amount per person fixed periodically by the Board of Governors<sup>1</sup> and are not conditioned on achievement of a sales target.

(B) An occasional meal, a ticket to a sporting event or the theater, or comparable entertainment which is neither so frequent nor so extensive as to raise any question of propriety and is not preconditioned on achievement of a sales target.

(C) Payment or reimbursement by offerors in connection with meetings held by an offeror or by a member for the purpose of training or education of associated persons of a member, provided that:

(i) associated persons obtain the member's prior approval to attend the meeting and attendance by a member's associated persons is not conditioned by the member on the achievement of a sales target or any other incentives pursuant to a non-cash compensation arrangement permitted by subparagraph (c)(2)(D);

(ii) the location is appropriate to the purpose of the meeting, which shall mean an office of the offeror or the member, or a facility located in the vicinity of such office, or a regional location with respect to regional meetings;

(iii) the payment or reimbursement is not applied to the expenses of guests of the associated person; and

(iv) the payment or reimbursement by the offeror is not conditioned by the offeror on the achievement of a sales target or any other non-cash compensation arrangement permitted by subparagraph (c)(2)(D).

<sup>1</sup> The current annual amount fixed by the Board of Governors is \$100.

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(D) Non-cash compensation arrangements between a member and its associated persons or a company that controls a member company and the member's associated persons, provided that no unaffiliated non-member company or other unaffiliated member directly or indirectly participates in the member's or non-member's organization of a permissible non-cash compensation arrangement; and

(E) Contributions by a non-member company or other member to a non-cash compensation arrangement between a member and its associated persons, provided that the arrangement meets the criteria in subparagraph (c)(2)(D).

A member shall maintain records of all non-cash compensation received by the member or its associated persons in arrangements permitted by subparagraphs (c)(2)(C)-(E). The records shall include: the names of the offerors, non-members or other members making the non-cash compensation contributions; the names of the associated persons participating in the arrangements; the nature and value of non-cash compensation received; the location of training and education meetings; and any other information that proves compliance by the member and its associated persons with subparagraph (c)(2)(C)-(E).

(c) Renumbered as (d).

\* \* \* \* \*

# Notice to Members

SEPTEMBER 2003

REQUEST FOR COMMENT

ACTION REQUESTED BY OCTOBER 17, 2003

## SUGGESTED ROUTING

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

## KEY TOPICS

NASD Rule 2830  
Revenue Sharing  
Investment Companies  
Advertising  
Variable Contracts

## Compensation for the Sale of Investment Company Securities

NASD Requests Comment on Proposed Amendments to Rule 2830 (Investment Company Securities); **Comment Period Expires October 17, 2003**

### Executive Summary

NASD proposes to amend Rule 2830 to require disclosure of revenue sharing and differential cash compensation arrangements relating to the sale of investment company securities. The proposal would require that a member disclose these compensation arrangements in writing when a customer first opens an account or purchases fund shares. The proposal also would require a member to update this information twice a year and make updates available to each customer.

NASD's proposal would:

- ▶ Broaden the definition of "cash compensation" in Rule 2830(b)(1)(C) to include cash payments received for inclusion of an investment company on a preferred sales list, in any other sales program (e.g., for shelf space) or as expense reimbursements;
- ▶ Add definitions of "differential cash compensation" and "gross dealer concessions" to Rule 2830(b); and
- ▶ Revise Rule 2830(l)(4) to ensure that members disclose revenue sharing arrangements and differential cash compensation arrangements to customers.

03-54

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## Questions/Further Information

Questions concerning this *Notice to Members* may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight, at (240) 386-4534; or Angela C. Goelzer, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight, at (202) 728-8120.

## Request for Comment

NASD requests comment on the proposed amendments to Rule 2830 described in this *Notice*. Members wishing to comment must make a submission that is received by **October 17, 2003**. Members and interested persons can submit their comments using the following methods:

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

Written comments submitted via hard copy should be mailed to:

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

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

Before becoming effective, any rule change resulting from this proposal must be adopted by the NASD Regulation Board of Directors, may be reviewed by the NASD Board of Governors, and must be approved by the Securities and Exchange Commission (SEC).

## Background

NASD members and their registered representatives are compensated for the sale of mutual fund shares in various ways, and the disclosure that investors receive depends upon the particular compensation arrangement. For example, member compensation that is deducted from a shareholder account or from fund assets, such as sales charges and Rule 12b-1 fees, is disclosed in the fee table that appears in the mutual fund prospectus. Other forms of member compensation, such as payments from a mutual fund adviser for "shelf space," have been the subject of less prominent disclosure.

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NASD reminds members that compensation arrangements may never undermine a member's obligation to properly supervise its registered representatives, or a registered representative's obligation to make only suitable recommendations to customers.<sup>1</sup> Members must adopt and implement procedures reasonably designed to ensure that all communications of their registered representatives concerning investment company products, whether written or oral, are accurate and complete.<sup>2</sup> In recommending an investment company, registered representatives must disclose all material information, including the fund's expenses and sales charges, investment objective and risks.

### **1. Rule 2830**

NASD rules regulate various compensation arrangements that present specific investor protection concerns. For example, NASD Conduct Rule 2830 effectively prohibits the payment of any form of compensation from third-party offerors to a member's associated persons. Rule 2830(l)(4) provides that a member may not accept cash compensation from an investment company offeror unless the compensation is described in the investment company's prospectus. The rule also prohibits a member from entering into "special cash compensation arrangements" with an investment company offeror unless the prospectus discloses the details of the arrangements. Earlier this year, NASD fined and censured two members for failing to disclose special cash compensation paid to dealer firms and to a group of registered representatives for the sale of mutual fund shares.<sup>3</sup>

Rule 2830(l)(5) prohibits the payment of most forms of non-cash compensation, such as lavish gifts and trips to resort locations, to registered representatives.<sup>4</sup> NASD has made clear to its members that this prohibition will be enforced in a manner that is appropriate in light of the purposes of the rule. Thus, for example, NASD has narrowly interpreted the "training and education exception" to the rule, forbidding reimbursement for tours, golf outings, and other forms of entertainment in connection with so-called "training and education meetings."<sup>5</sup>

### **2. Proposed Amendments**

NASD is now proposing a disclosure approach concerning two types of compensation arrangements that present investor protection concerns. These two types of compensation arrangements are:

- ♦ Revenue sharing arrangements, in which an investment adviser or other offeror agrees to pay an NASD member cash compensation not otherwise disclosed in the prospectus fee table (such as payments for "shelf space" to distribute the investment company's shares); and
- ♦ Differential cash compensation arrangements, typically occurring when a member provides higher payouts to its registered representatives for the sale of certain investment company products, such as investment companies that are proprietary funds of the member.

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Revenue sharing and differential cash compensation arrangements may create incentives to inappropriately favor some funds over others, or to favor funds over non-fund investments. These compensation arrangements can create conflicts of interest by encouraging members and their registered representatives to recommend certain funds to maximize their compensation, rather than to best meet their customers' needs. They may provide point-of-sale incentives that could compromise proper customer suitability considerations and may present a situation in which the salesperson's interests are not, in some circumstances, fully aligned with the interests of customers.

Disclosure of revenue sharing and differential cash compensation arrangements would enable investors to evaluate whether a registered representative's particular product recommendation was inappropriately influenced by these arrangements. Disclosure of these arrangements could be an important adjunct to existing suitability, sales practice, and disclosure requirements and may help ensure that there is an appropriate match between the needs of an investor and the most appropriate investment company.

Congress and the SEC also are considering the adequacy of disclosure regarding mutual fund fees and broker/dealer compensation for fund sales, and Congress may enact legislation or the SEC may issue separate proposals addressing these matters. In July, SEC Chairman Donaldson asked his staff "to move ahead with the prospectus disclosure recommendations of the Task Force on Breakpoints and to develop additional investor protection initiatives concerning the costs and conflicts of interest in mutual fund investments." Chairman Donaldson also anticipated that "the Commission will consider additional regulation in this critical area of our markets in the near future."<sup>6</sup> It is possible that Congressional or SEC action would require enhanced disclosure in the mutual fund prospectus, periodic reports, or confirmation statements. Such enhanced disclosure will be complementary to NASD's proposal. NASD will continue to work with Congress and the SEC on these investor protection initiatives.

## The Proposal

### 1. Required Disclosure

NASD proposes to amend Rule 2830 to better ensure that members disclose to their customers information about revenue sharing and differential cash compensation arrangements. The proposal recognizes that both revenue sharing and differential cash compensation arrangements may come in a variety of forms. For example, revenue sharing arrangements may include cash payments from a fund's investment adviser and expense reimbursements. A differential cash compensation arrangement may consist of a system under which a firm imposes ticket charges on their registered representatives for the sale of some, but not all, investment companies. Thus, a registered representative may not have to pay a ticket charge for the sale of a proprietary investment company, but may have to pay one for the sale of a nonproprietary investment company.

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Rule 2830(l)(4) would be revised to require that any member that within the previous twelve months has received from an investment company offeror cash compensation, or that uses differential cash compensation policies in compensating its associated persons, must disclose:

- ▶ That information about a fund's fees and expenses may be found in the fee table located in the fund's prospectus and that the fund's statement of additional information contains information about how the fund selects brokers.
- ▶ If applicable, that the member receives cash payments from fund offerors other than the sales charges (including Rule 12b-1 fees) and service fees disclosed in the prospectus fee table. The member also would have to list the offerors that made these payments to the member in descending order based upon the total amount of compensation received from each offeror. The member would not have to disclose the actual amounts of compensation received under these arrangements.<sup>7</sup>
- ▶ If applicable, that an associated person (including a registered representative or branch manager) receives different rates of compensation depending upon which investment company shares are purchased by a customer, the nature of these arrangements, and the names of the investment companies favored by these arrangements. This disclosure requirement would not apply to arrangements under which different associated persons receive different payout ratios, so long as an individual associated person receives the same payout ratio for all funds that he or she sells. This disclosure requirement also would not apply to differences in total compensation received by the associated person, such as for the sale of an investment company that provides a higher gross dealer concession to the member, provided that the payout ratios are the same for all funds that the associated person sells.
- ▶ A Web page or toll-free telephone number that a customer may use to obtain updated information about the member's revenue sharing and differential cash compensation arrangements. A member may choose not to maintain a Web page or toll-free number that provides updated information, but then must disclose that updated information will be sent to the customer on a semi-annual basis.

Rule 2830 also would be amended to provide that the required disclosures must be updated on a semi-annual basis and must be made in writing to the customer:

- ▶ At the time that the customer establishes an account with the member or the member's clearing broker;
- ▶ If no account is established, at the time that the customer first purchases shares of an investment company;

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- ▶ For accounts that are in existence at the time that the proposed revisions to Rule 2830 become effective, at the later of ninety days after the effective date or the time at which the customer first purchases fund shares following the effective date.

The proposal would retain, with modification, the current requirements in Rule 2830(l)(4) regarding prospectus disclosure of cash compensation arrangements.<sup>8</sup> The modifications are designed to clarify a member's obligation not to accept any sales charges or service fees that are not described in a current fund prospectus. If a special sales charge or service fee arrangement is made available to some, but not all, members who distribute a fund's securities, the arrangement must be described in the fund's prospectus. Thus, consistent with current policy, if an offeror pays a higher percentage of a mutual fund's sales charges to one member than it pays to other members, the details of this special cash compensation arrangement would have to be disclosed in the fund's prospectus. NASD has interpreted Rule 2830(l)(4) to allow this required disclosure to be presented in a fund's Statement of Additional Information (SAI).<sup>9</sup>

NASD seeks comment on whether SAI disclosure is an effective means to communicate with investors about special cash compensation arrangements. Should NASD require prospectus, rather than SAI, disclosure of these arrangements? Should the current requirements of Rule 2830(l)(4) be eliminated in light of the disclosure that would be required by the proposed amendments? If prospectus disclosure requirements are retained, should NASD provide additional guidance concerning the circumstances under which Rule 2830(l)(4) mandates disclosure and the level of detail that may be deemed appropriate?

## **2. Cash Compensation**

The definition of "cash compensation" set forth in Rule 2830(b)(1)(C) would be amended to include cash payments received as a condition for inclusion of the investment company on a preferred or select sales list, in any other sales program (e.g., for shelf space), or as expense reimbursement.<sup>10</sup> The definition also would be clarified to expressly include gross dealer concessions.

## **3. Differential Cash Compensation**

Rule 2830(b)(1) would be amended to add a definition of "differential cash compensation." The definition is designed to encompass any compensation arrangement under which a member pays an associated person different rates of compensation depending upon which investment company securities (or classes thereof) are sold. For example, a differential cash compensation arrangement would be deemed to exist whenever a member pays an associated person a higher percentage of the member's "gross dealer concessions" for the sale of one fund's securities than the percentage paid for sale of the same dollar amount of another fund's securities. A differential compensation arrangement also would be found when a member sponsors a cash sales contest with sales targets that favor certain funds, or when a member imposes or waives ticket charges for the sale of certain funds. The proposed definition

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would not be limited to differential cash compensation arrangements favoring proprietary funds. Also, the definition would encompass payments to any associated person, including a registered representative or branch manager.

NASD requests comment on whether money market funds should be excluded from the differential cash compensation provision. For example, a differential cash compensation arrangement could be deemed to exist whenever payout ratios are higher for the sale of one investment company than for another investment company that is not a money market fund. This provision would permit lower payouts for money market funds without mandating disclosure.

#### **4. Gross Dealer Concessions**

Integral to the proposed definition of “differential cash compensation” is NASD’s proposed definition of “gross dealer concessions.” Gross dealer concessions would be defined as the total amount of any compensation received by a member from an offeror for the sale of investment company securities, including all discounts, concessions, service fees, commissions, and asset-based sales charges.

#### **5. Alternative Approaches**

NASD seeks comments on alternatives to the proposed amendments. For example:

- ◆ As proposed, a member would provide the required disclosure when a customer first establishes an account with a member or the member’s clearing broker, or when the customer first purchases investment company shares. Are these the most appropriate times for a customer to receive the information? Would it be more appropriate for a customer to receive the information when he or she first receives a recommendation to purchase investment company shares, rather than at the opening of a brokerage account?
- ◆ Would investors be well served by disclosure that provides a general “warning label” urging them to seek information from the member or its associated person concerning revenue sharing and differential cash compensation arrangements, rather than receiving a list of relevant funds?
- ◆ In addition to the proposed disclosure, should NASD require disclosure of the actual dollar amounts paid under revenue sharing and differential cash compensation arrangements?
- ◆ What are the costs and benefits of the proposed amendments and the alternative approaches?
- ◆ Are there any other types of arrangements that should be covered by the rule due to the conflicts of interest that may be presented?

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With regard to disclosure of revenue sharing arrangements:

- ▶ NASD specifically seeks comment on whether it would be appropriate for Rule 2830 to establish a de minimis threshold below which disclosure of revenue sharing would not be required and, if so, the appropriate level of a threshold for disclosure.
- ▶ As proposed, a member that receives revenue sharing payments would be required to list the offerors that make the payments in descending order based upon the amount received by each. NASD requests comment on whether other listing requirements would be more appropriate. For example, offerors could be grouped according to the size of their revenue sharing payments (e.g., by highest to lowest quartile or quintile), without ranking the offerors in descending order within each group. Another alternative might be to list offerors according to revenue sharing payments per \$10,000 in fund sales, rather than based on total payments per fund.

NASD also seeks comment on whether the proposed definition of differential cash compensation should be broadened. As proposed, differential cash compensation would include arrangements in which a registered representative receives a higher percentage of the gross dealer concession for one fund than he or she would receive for the sale of another investment company. One alternative would be to expand this definition to include other circumstances in which the sale of the same dollar amount of different funds results in differing levels of compensation. For example, a registered representative may receive identical payout ratios for the sale of different funds, but the sale of one may result in higher compensation because the gross dealer concession is greater in absolute dollars.

More generally, NASD seeks comment on whether the proposal should be expanded to require disclosure of revenue sharing and differential compensation arrangements with respect to products other than investment companies, such as variable annuities. Would imposition of the proposed disclosure requirements solely on investment companies create incentives for registered representatives to favor other investment products?

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## Endnotes

- 1 NASD strictly monitors its members' sales practices in connection with the distribution of mutual funds and related investment products. For example, NASD's heightened scrutiny of sales practices in connection with the distribution of both mutual funds and variable annuities has resulted in over 75 disciplinary actions since the beginning of 2001.
- 2 See, e.g., *Notice to Members 98-107* (NASD Reminds Members Of Their Obligation To Disclose Mutual Fund Fees) and *Notice to Members 94-16* (NASD Reminds Members Of Mutual Fund Sales Practice Obligations).
- 3 See *NASD Regulatory and Compliance Alert* (Spring 2003). The respondents did not admit or deny the allegations but consented to the entry of findings.
- 4 See *Notice to Members 98-75* (amending Rules 2820 and 2830 to limit the extent to which members may pay or accept non-cash compensation).
- 5 See *NASD Regulatory and Compliance Alert* (Summer 2000).
- 6 SEC Press Release No. 2003-84 (July 22, 2003).
- 7 The proposal would not require a member to disclose receipt of non-cash compensation permitted by Rule 2830(l)(5), such as gifts under \$100, occasional meals, tickets to theater and sporting events, and reimbursement for associated persons' expenses in attending permissible training or education meetings.
- 8 Rule 2830(l)(4) provides in part that "[n]o member shall accept any cash compensation from an offeror unless such compensation is described in a current prospectus of the investment company. When special cash compensation arrangements are made available by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the investment company securities of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus."
- 9 See *Notice to Members 99-55* (Question #18).
- 10 Thus, the definition of "cash compensation" would include payments, made from an offeror other than an investment company, received by members for the sale of fund shares or payments based on the amount of fund assets held in accounts at the member. The definition would not include directed brokerage to a member. Of course, the prohibitions of Rule 2830(k) would still apply even after adoption of the proposed amendments. Rule 2830(k) generally prohibits a member from directly or indirectly seeking brokerage commissions as a condition to the sale or distribution of investment company securities.

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## ATTACHMENT A

### Text of Proposed Amendments

Rule 2830(b)(1)(C) is revised to read as follows:

(C) "Cash compensation" shall mean any cash payment received in connection with the sale or distribution of investment company securities, including but not limited to:

- (i) any discount, concession, gross dealer concession, fee, service fee, commission, asset-based sales charge, loan, override, cash employee benefit; or
- (ii) any cash payment received as a condition for inclusion of the investment company on a preferred or select sales list; in any other sales program; or as an expense reimbursement.

New Rules 2830(b)(1)(F) and (G) are inserted as follows:

(F) "Differential cash compensation" shall mean

- (i) the payment by a member to its associated persons of a higher percentage of the member's gross dealer concessions for the sale of a stated dollar amount of the securities of a particular investment company (or any class thereof) than the percentage of its gross dealer concessions that the member pays to its associated persons for the sale of the same dollar amount of securities of another investment company (or any class thereof); and
- (ii) other practices of a member that cause an associated person to earn different rates of compensation for investment company products (or classes thereof) depending on the product sold, including but not limited to a member's payment of additional cash compensation or the imposition or waiver of ticket charges for associated persons concerning the sale of particular investment company securities.

(G) "Gross dealer concessions" shall mean the total amount of any discounts, concessions, fees, service fees, commissions or asset-based sales charges provided by the offeror to the member in connection with the sale and distribution of investment company securities.

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Rule 2830(l)(4) is revised to read as follows:

(A) No member shall accept any sales charges or service fees from an offeror unless such compensation is described in a current prospectus of the investment company. When special sales charge or service fee arrangements are made available by an offeror to a member, which arrangements are not made available on the same terms to all members who distribute the investment company securities of the offeror, a member shall not enter into such arrangements unless the name of the member and the details of the arrangements are disclosed in the prospectus.

(B) Any member that has within the previous 12 months received from an offeror any form of cash compensation, other than sales charges or service fees disclosed in the prospectus fee table, or that employs policies that involve differential cash compensation, must:

(i) disclose that information about an investment company's fees and expenses may be found in the fund's prospectus and that the company's policies regarding selection of brokers (including soft dollar practices) may be found in the fund's statement of additional information;

(ii) disclose, if applicable, that the member receives cash payments from an offeror, other than sales charges or service fees disclosed in the prospectus fee table, the nature of any such cash payments received in the past 12 months, and the name of each offeror that made such a cash payment, listed in descending order based upon the amount of compensation received from each offeror;

(iii) disclose, if applicable, that the associated person receives different rates of compensation for different investment company products that may provide an incentive to offer specific products to the customer, a description of the differential cash compensation policy, and the names of the investment company or companies whose sales the policy favors; and

(iv) provide a reference (or in the case of electronically delivered documents, a hyperlink) to the web page or toll-free telephone number described in paragraph (D). If the member elects not to maintain a web page or toll-free telephone number as described in paragraph (D), the member must disclose that updated information described in this paragraph (B) will be sent to the customer on a semi-annual basis.

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(C) The disclosure required by paragraph (B) must be updated on a semi-annual basis and must be made in written documentation:

- (i) at the time that the customer establishes an account with the member or the member's clearing broker;
- (ii) if no such account is established, by the time the customer first purchases shares of an investment company; or
- (iii) with respect to accounts existing when paragraph (B) becomes effective, the later of (a) 90 days after the effective date, or (b) the time the customer first purchases shares of an investment company after the effective date (other than purchases through reinvestment of dividends or capital distributions or through automatic investment plans).

(D) Any member that receives cash payments from investment companies and their affiliates, other than sales charges or service fees disclosed in the prospectus fee table, or that employs policies that involve differential cash compensation, must either:

- (i) maintain a web page or toll-free telephone number that is available to the public and that provides updated information described in paragraph (B); or
- (ii) send updated information described in paragraph (B) in written form on a semi-annual basis to its customers who originally received this disclosure.

(E) Other than disclosures regarding differential cash compensation, the requirements of Rule 2830(l)(4)(B) shall not apply to cash compensation in the form of a sales charge or service fee disclosed in the prospectus fee table of the offeror's investment company.

# Notice to Members

SEPTEMBER 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 October 6, 2003

#### Executive Summary

On September 4, 2003, the Securities and Exchange Commission (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 October 6, 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 October 6, 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).

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.

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## 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 ECN's 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, simultaneously, advance written notice 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.

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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 a market maker. 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 a non-member customer, the routing ECN would be identified as the reporting party. If the executing ECN matched the routed order against the order of a market maker or another ECN, however, the sell side 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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## ATTACHMENT A

### Notice Required by NASD Rule 6130(c) for Electronic Communications Network (ECN) Transactions Reported through the Automated Confirmation Transaction Service (ACT)

Name of ECN:

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Address:

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Contact person:

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Name of ECN subscriber

(if the same method will be used for all subscribers, the subscribers are not required to be identified by name):

Trade-Reporting Method

(identified by number as indicated below):

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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

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## 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.

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(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

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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.

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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 a Market Maker and a member for purposes of the rules for determining reporting parties reflected in paragraphs (1), (2), 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;

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(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	Non-[Designated] Registered Reporting Member	Exchange	Customer
[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	Non-[Designated] Registered Reporting Member	Exchange	Customer
[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

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\* \* \* \* \*

## 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.

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\* \* \* \* \*

**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

SEPTEMBER 2003

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registration  
Senior Management

## KEY TOPICS

Central Registration Depository  
Form U4  
New Member Application  
Rule 1013  
Rule 1140

INFORMATIONAL

## Forms U4

Rule Amendments to Require Member Applicants to File Forms U4 Electronically; **Operative Date: October 27, 2003**

### Executive Summary

NASD has amended Rule 1013 (New Member Application and Interview) to eliminate the requirement that new member applicants include in their membership applications signed, paper Forms U4 for their proposed associated persons. Rule 1013, as amended, requires new member applicants to file these Forms U4 electronically. NASD also has amended Rule 1140 (Electronic Filing Rules) to require new member applicants to follow the same procedures members must follow when making electronic Form U4 filings. The approved rule changes also make certain technical changes to Rules 1013 and 1140. Questions and answers explaining how members should comply with the amendments are included in Attachment A. The amendments are included with this *Notice* as Attachment B. The amendments to Rules 1013 and 1140 were filed with the Securities and Exchange Commission for immediate effectiveness on August 28, 2003;<sup>1</sup> the amendments, however, do not become operative until October 27, 2003.

### Questions/Further Information

Questions concerning this *Notice* may be directed to the Office of General Counsel, NASD Regulatory Policy and Oversight: Patricia Albrecht, Assistant General Counsel, (202) 728-8026.

03-56

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## Background

As part of its effort to make the membership application process more efficient and less burdensome for applicants, NASD has amended Rule 1013 and Rule 1140 to require that member applicants, upon approval of their Web CRD entitlement request forms, file their Forms U4 electronically via Web CRD.

### NASD Rule 1013 – New Member Application and Interview

Rule 1013(a)(2) (Contents) identifies the items an applicant must submit with its new membership application. The amendment to Rule 1013 eliminates Rule 1013(a)(2)(B), which currently requires an applicant to include in its membership application an original, signed paper Form U4 for each of the applicant's proposed associated persons who are required to be registered with NASD. Instead, Rule 1013(a)(3) (Electronic Filings), as amended, requires that upon approval of the applicant's Web CRD entitlement request form, the applicant must file all required Forms U4 electronically via Web CRD. The electronic filing requirement allows an applicant to use one unified process for all Form U4 submissions in the membership application process, reduces the amount of paperwork the applicant must submit with its membership application, and eliminates the need for NASD staff to separate the Forms U4 from the membership application material and route them to the appropriate office for review and entry into the Web CRD system. Because Rule 1013(a)(3) will require an applicant to file Forms U4 directly with Web CRD, NASD Web CRD staff will not experience any delays that might occur as a result of the routing process.

### Process for Filing Electronic Forms U4

Rule 1013(a)(2)(R) requires an applicant to submit with its membership application a Web CRD entitlement request form. NASD Registration and Disclosure (RAD) will send the Web CRD entitlement request form to the applicant if it was not included in the application. Upon receipt of the completed Web CRD entitlement request form, RAD will, as appropriate, approve the form and provide the applicant with access to Web CRD.

Upon approval of the applicant's Web CRD entitlement request form, amended Rule 1013(a)(3) requires that the applicant submit electronically, among other things, Forms U4 for its proposed associated persons who are required to register under NASD rules. NASD expects an applicant to file Forms U4 for all proposed associated persons who are not yet registered with NASD within two weeks of receiving Web CRD access. Receiving such information within this two-week window will enable NASD staff to review the person's background information at an early stage in the application process.

In contrast, in the case of proposed associated persons who are already registered with NASD at the time the applicant submits its membership application (and thus for whom NASD already possesses significant background information), the applicant may submit electronic Forms U4 for such persons at any time prior to the approval of the membership application; provided, however, that if a currently registered person needs

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to take a qualifying examination, the applicant must file the registered person's Form U4 early enough in the process to allow the registered person to take the necessary examination in a timely manner. In this regard, Rule 1014(a) (Standards for Admission) requires all associated persons to have the applicable licenses and registrations.<sup>2</sup> NASD's current policy allows each individual a 90-day window to pass all required examinations following the filing of an electronic Form U4.<sup>3</sup>

## NASD Rule 1140 – Electronic Filing Rules

In connection with the new electronic Form U4 filing requirement, NASD also has amended Rule 1140. Rule 1140, as amended, subjects applicants to the same electronic filing requirements that members must follow when filing electronic Forms U4. Rule 1140 requires every electronic Form U4 filing made by a member to be based on a signed Form U4 provided by the associated person. In addition, Rule 1140 requires members, as part of their recordkeeping requirements, to retain the signed Forms U4 and make them promptly available upon regulatory request. Rule 1140, as amended, requires applicants to follow these same procedures when making electronic Form U4 filings. Among other things, these requirements will help ensure that each associated person has reviewed and confirmed the information set forth in the electronic Form U4, and has undertaken all related representations in the Form U4.

## Technical Changes to NASD Rules 1013 and 1140

Finally, the amendments to Rules 1013 and 1140 make several technical changes, including:

- ◆ The references in these rules to "Form U-4" and "Form U-5" have been changed to "Form U4" and "Form U5," respectively.<sup>4</sup>
- ◆ Rule 1140 has been amended to replace references to "applicant" in Rule 1140 with references, as appropriate, to persons on whose behalf Forms U4 filings are being made.

## Endnotes

1 SR-NASD-2003-136 (August 28, 2003); SEC Release No. 34-48448 (September 4, 2003); 68 FR 53626 (September 11, 2003).

2 Rule 1014(a)(2).

3 See NASD's "How to Become a Member" Web Page at [www.nasdr.com/4700\\_toc.htm](http://www.nasdr.com/4700_toc.htm).

4 This change is being made in accordance with SR-NASD-2003-57 (Rule Change to Revise Uniform Application for Securities Industry Registration or Transfer (Form U-4) and Uniform Termination Notice for Securities Industry Registration (Form U-5)), which changed the references for Forms "U-4" and "U-5" to "U4" and "U5." See SEC Release No. 34-48161 (July 10, 2003), 68 FR 42444 (July 17, 2003).

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## ATTACHMENT A

### Questions and Answers Regarding Compliance With Amended NASD Rules 1013 and 1140

- Q:** Are the paper Forms U4 filed by applicants being replaced entirely by electronic Form U4 filings?
- A:** Yes. The requirement in Rule 1013(a)(2)(B) that a membership applicant must file signed, paper Forms U4 has been eliminated. Rule 1013(a)(3) has been amended to require that, upon approval of a membership applicant's Web CRD entitlement request form, the applicant must file Forms U4 electronically via Web CRD.
- Q:** Is the electronic Form U4 based on a signed, paper Form U4?
- A:** Yes, the electronic Form U4 is based on a signed, paper Form U4. Rule 1140(c) clarifies that all Forms U4 filed electronically must be based on a signed Form U4 that is provided to the member or an applicant for membership by the person.
- Q:** Who will retain the signed Form U4 and how will NASD obtain a copy if it needs it?
- A:** NASD Rule 1140 requires the member to retain the signed Form U4 and make it available promptly upon regulatory request.
- Q:** How does an applicant comply with amended Rule 1013(a)(3)?
- ▶ If a person who is not yet registered with NASD wants to become a registered person of the applicant, the applicant must, within two weeks of receiving Web CRD access, electronically file the Form U4 for such person. Receiving such information within this two-week window will enable NASD staff to review the person's background information at an early stage in the application process.
  - ▶ If a person who is already registered with an NASD member (and thus for whom NASD already possesses significant background information) wants to become a registered person of the applicant, the applicant may submit electronic Forms U4 for such person at any time prior to the approval of the membership application; provided, however, that if a currently registered person needs to take a qualifying examination, the applicant must file the registered person's Form U4 early enough in the process to allow the registered person to take the necessary examination in a timely manner.

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## ATTACHMENT B

### 1000. Membership, Registration and Qualification Requirements

\* \* \* \* \*

### 1013. New Member Application and Interview

#### (a) Filing of Application

##### (1) Where to File

An Applicant for [Association] NASD membership shall file its application with the Department of Member Regulation at the district office in the district in which the Applicant intends to have its principal place of business as defined in Rule 1011(l).

##### (2) Contents

The application shall include:

(A) an original signed and notarized paper Form BD, with applicable schedules;

[(B) an original signed paper Form U-4 for each Associated Person who is required to be registered under the Rules of the Association;]

(C) through (H) Renumbered as (B) through (G).

[(I)] (H) documentation of any of the following events, unless the event has been reported to the Central Registration Depository:

(i) through (ii) No change.

(iii) an investment-related customer complaint or arbitration that is required to be reported on Form U4 [U-4];

(iv) through (v) No change.

(J) through (S) Renumbered as (I) through (R).

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### (3) Electronic Filings

Upon approval of the Applicant's Web CRD entitlement request form, the Applicant shall submit its Forms U4 for each Associated Person who is required to be registered under NASD Rules, any amendments to its Forms BD or U4 [U-4], any additional Forms U-4], and any Form U5 [U-5] electronically via Web CRD.

\* \* \* \* \*

(4) through (7) No change.

(b) No change.

\* \* \* \* \*

## 1140. Electronic Filing Rules

(a) through (b) No change.

### (c) Form U4 [U-4] Filing Requirements

(1) [Initial and transfer electronic application filings] Every initial and transfer electronic Form U4 filing shall be based on a signed Form U4 [U-4] provided to the member or applicant for membership by the person on whose behalf the Form U4 is being filed [applicant]. As part of the member's recordkeeping requirements, it shall retain the [applicant's] person's signed Form U4 [U-4] and make it available promptly upon regulatory request. An applicant for membership also must retain every signed Form U4 it receives during the application process and make them available promptly upon regulatory request.

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(2) Fingerprint Cards

Upon filing an electronic Form U4 [U-4] on behalf of [an applicant] a person applying for registration, a member shall promptly submit a fingerprint card for [the applicant] that person. NASD [Regulation] may make a registration effective pending receipt of the fingerprint card. If a member fails to submit a fingerprint card within 30 days after NASD [Regulation] receives the electronic Form U4 [U-4], the person's registration shall be deemed inactive. In such case, NASD [Regulation] shall notify the member that the person must immediately cease all activities requiring registration and is prohibited from performing any duties and functioning in any capacity requiring registration. NASD [Regulation] shall administratively terminate a registration that is inactive for a period of two years. A person whose registration is administratively terminated may reactivate the registration only by reapplying for registration and meeting the qualification requirements of the applicable provisions of the Rule 1020 Series and the Rule 1030 Series. Upon application and a showing of good cause, [the Association] NASD may extend the 30-day period.

(d) through (e) No change.

\* \* \* \* \*

# Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

Continuing Education  
Legal & Compliance  
Registration  
Senior Management

## KEY TOPICS

Continuing Education  
Firm Element

INFORMATIONAL

## Continuing Education

Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory

### Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council) has issued the annual *Firm Element Advisory*, a guide for firms to use when developing their continuing education Firm Element training plans. The Council recommends that firms use the *Firm Element Advisory* as part of the Firm Element Needs Analysis to help identify relevant training topics for all covered persons, including supervisors. New rules or regulations, such as the Research Analyst Rules; major regulatory examination findings, such as those relating to mutual fund sales practices; ethics and professional conduct; and any new products or services the firm plans to offer should be considered as topics for Firm Element training.

All of the training resources found in the *Firm Element Advisory* may be found on the CE Council Web Site at [www.securitiescep.com](http://www.securitiescep.com), where there are also two additional Firm Element resources. The first is the *Firm Element Organizer*, an easy-to-use software application that enables a search of an extensive database of training resources related to specific investment products or services. The second resource comprises CDs with scenarios taken from the Regulatory Element Supervisor (S201) and General (S101) programs. Log on to the Council Web Site for descriptions of the available scenarios.

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## Questions/Further Information

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

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The Securities Industry Continuing Education Program

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## Securities Industry Continuing Education Program Firm Element Advisory

Each year the Securities Industry/Regulatory Council on Continuing Education (Council) publishes the *Firm Element Advisory* to identify current regulatory and sales practice issues for possible inclusion in Firm Element training plans. This year's topics have been taken from a review of industry regulatory and self-regulatory organization (SRO) publications issued since the last *Firm Element Advisory* of October 2002.

The Council recommends that firms use the *Firm Element Advisory* as part of a firm's Firm Element Needs Analysis to identify training topics that are relevant to the firm, including training for supervisors. New rules or regulations, such as the Research Analyst Rules; major regulatory examination findings, such as those relating to mutual fund sales practices; ethics and professional conduct; and any new products or services the firm plans to offer should be considered as topics for Firm Element training.

The Council provides a convenient way for firms to access the training resources listed next to each topic in the *Firm Element Advisory*—the CE Council Web Site at [www.securitiescep.com](http://www.securitiescep.com). In addition to the *Firm Element Advisory* material, there are also two additional resources to assist with Firm Element requirements. The first is the *Firm Element Organizer*. This is an easy-to-use software application that enables you to search an extensive database of training resources related to specific investment products or services you identify. The results of a search can then be edited into a document that will assist developing a Firm Element training plan. A tutorial on the CE Council Web Site demonstrates how to use the *Firm Element Organizer*. The second potential Firm Element resource comprises scenarios taken from the Regulatory Element Supervisor (S201) and General (S101) programs that may be suitable for Firm Element training.

For more information, log on to [www.securitiescep.com](http://www.securitiescep.com), or phone Roni Meikle, Continuing Education Manager, New York Stock Exchange (212-656-2156), or John Linnehan, Director, Continuing Education, NASD (240-386-4684).

## Training Topics and Relevant Training Points and References

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### Anti-Money Laundering

Anti-money laundering is an evolving topic. Many new rules and regulations have been adopted over the past two years to carry out the mandates of the USA PATRIOT Act. These requirements place additional due diligence, reporting, and training responsibilities on firms, supervisors, and registered representatives. Many SROs and government agencies maintain Web sites on anti-money laundering, including NASD ([www.nasdr.com/money.asp](http://www.nasdr.com/money.asp)), the U.S. Treasury ([www.ustreas.gov](http://www.ustreas.gov) => Bureaus => Financial Crimes Enforcement Network (FinCen) ([www.fincen.gov](http://www.fincen.gov))), and the SIA ([www.sia.com](http://www.sia.com) => Reference Materials => Anti-Money Laundering Guidance).

See also, MSRB Notice 2003-28 (July 16, 2003), Approval by SEC of Rule G-41, on *Anti-Money Laundering Compliance*, NASD Notice To Members 02-47, *Anti-Money Laundering: Treasury Issues Final Suspicious Activity Reporting Rule For Broker/Dealers*, August 2002; NASD Notice to Members 03-34, *Anti-Money Laundering Customer Identification Programs for Broker/Dealers*, June 2003, and NYSE Information Memos 03-32, *Customer Identification Programs For Broker-Dealers*, July 14, 2003; 03-03, *Lifting Of The Temporary Moratorium On Information Requests Under Section 314 Of The USA PATRIOT Act*, February 20, 2003; 02-64, *USA PATRIOT Act Updates: Section 356 Requirement To Report Suspicious Transactions; Deadline Extension For Sections 313 And 319*, December 24, 2002; 02-46, *Compliance With Section 326 ("Verification Of Identification") Of The USA PATRIOT Act*, October 31, 2002 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

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### Brokered Certificates of Deposit

NASD and the NYSE have provided guidance to their members that offer non-traditional certificate of deposit (CD) products. Typically, these products are long-term CDs offered by "deposit brokers" that carry a maturity date of more than one year, are callable at the discretion of the issuer, and trade in a secondary market. In certain circumstances, these products are securities. Irrespective of whether a particular CD product is a security, members must ensure that their registered representatives are properly trained and informed about the products, and that customers receive adequate disclosure of risk factors. Members are advised to carry CD products at fair market value on customer account statements. See *Notice to Members 02-69, Certificates of Deposit: Clarification of Member Obligations Regarding Brokered Certificates of Deposit*, October 2002; NYSE Information Memo 01-19, *Long-Term Certificates Of Deposit – Sales Practices*, July 20, 2001 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

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## **Business Conduct**

### *Ethics*

Firms should be aware of the importance of ethics and professional responsibility as topics to include in their Firm Element training programs. Although the Securities Industry/Regulatory Council on Continuing Education (CE Council) will enhance the Regulatory Element programs via the introduction of scenarios and cases that will stress awareness of the ethical dimension to situations involving conflicts of interest, peer pressure, reputational risk, etc., Firm Element programs have certain advantages. Firm Element programs can utilize small, personal, and interactive training settings where different viewpoints and values can be expressed, evaluated, and shared. They can also deal with issues that are specific to the firm.

Beginning in 2004, when amendments to SRO continuing education rules regarding research analysts become effective (see *Research Analysts' Conflicts of Interest*, below), research analysts will be required to be registered and will be subject to the Firm Element as well as the Regulatory Element. Firm Element training for research analysts, and their immediate supervisors, must include ethics, professional responsibility, and other more specific topics. While not mandated for all other registered persons, the CE Council urges firms to carefully consider ethics and professional responsibility as they relate to other Firm Element training topics.

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### *Guarantees and Sharing in Customer Accounts*

On February 12, 2003, the Securities and Exchange Commission (SEC) approved amendments to NASD Rules 2330(e) (Prohibition Against Guarantees) and 2330(f) (Sharing in Accounts; Extent Permissible). The amendments to Rule 2330(e) clarify that members and their associated persons are prohibited from guaranteeing any customer against loss in connection with any securities transaction or in any securities account of the customer. Rule 2330(f) has been amended to require that associated persons obtain prior written authorization from their employing member firm and that members and associated persons obtain prior written authorization from the customer before sharing in a customer's account. The amendments also delete from Rule 2330(f) the requirement that members and associated persons obtain the prior written authorization of the member carrying the account before sharing in a customer's account. See *NASD Notice to Members 03-21, Prohibition Against Guarantees and Sharing in Customer Accounts*, April 2003. See also NYSE Rule 352 (Guarantees and Sharing in Accounts) related to this topic.

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**Hedge Funds**

Broker/dealers that offer hedge funds to their clients must fulfill their obligations to 1) provide balanced disclosure in promotional efforts; 2) perform a reasonable-basis suitability determination; 3) perform a customer-specific suitability determination; 4) supervise associated persons selling hedge funds and funds of hedge funds; 5) train associated persons regarding the features, risks, and suitability of hedge funds. See *NASD Notice to Members 03-07, NASD Reminds Members of Obligations When Selling Hedge Funds*, February 2003, and NASD Investor Alert, *Funds Of Hedge Funds – Higher Costs And Risks For Higher Potential Returns*, August 23, 2002, at [www.nasdr.com/alert\\_hedgefunds.htm](http://www.nasdr.com/alert_hedgefunds.htm).

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**Municipal Fund Securities****529 Plan Sales  
Material**

The market for municipal fund securities, especially Section 529 College Savings Plans, is growing. Municipal fund securities represent investments in pools of securities, such as securities issued by registered investment companies. Municipal fund securities are municipal securities regulated by the MSRB. All sales materials related to them must comply with MSRB rules, including MSRB Rule G-21. In addition, certain sales materials for municipal fund securities must also comply with the advertising rules of the SEC and NASD, including NASD Rule 2210. See *NASD Notice to Members 03-17, Municipal Fund Securities: Sales Material for Municipal Fund Securities*, March 2003.

Principals supervising the sale of municipal fund securities must be appropriately qualified and hold either a Series 53 or Series 51 license. For more information, see NASD's Web Site at [www.nasd.com/Investor/Choices/College/](http://www.nasd.com/Investor/Choices/College/) and the MSRB Web Site at [ww1.msrb.org/msrb1/mfs/default.asp](http://ww1.msrb.org/msrb1/mfs/default.asp).

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**Sales to  
Employees of  
Other Dealers**

MSRB Rule G-28 has been amended to exempt transactions in municipal fund securities from the requirement that a dealer opening an account for another dealer's employee (or a spouse or child of the employee) provide notice to the other dealer and follow the other dealer's instructions with respect to transactions for the employee (or spouse or child).

See MSRB Notice 2003-9 (March 4, 2003), *SEC Approves Amendment to Rule G-28 on Sales to Employees of Other Dealers* ([ww1.msrb.org/msrb1/archive/G-28approval.htm](http://ww1.msrb.org/msrb1/archive/G-28approval.htm)).

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## **Municipal Securities**

### *Consultants*

MSRB Rule G-38 defines a consultant as any person used by a dealer to obtain or retain municipal securities business through direct or indirect communication by such person with an issuer on the dealer's behalf where the communication is undertaken by such person in exchange for, or with the understanding of, receiving payment from the dealer or any other person. Dealers must disclose to issuers certain information about their consultants and report certain information about their consultants to the MSRB on Form G-37/G-38, including certain of their consultants' political contributions to issuer officials and payments to state and local political parties.

See MSRB Rule G-38: Consultants, *MSRB Rule Book*.

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### *Political Contributions and Prohibitions on Municipal Securities Business*

A recent rule change revised the definition of municipal finance professional (MFP) so that associated persons "primarily engaged" in municipal securities representative activities based on their retail sales of municipal securities are excluded from the definition. Any retail sales representatives who solicit municipal securities business from issuer officials remain covered under the rule as MFPs.

The look back and look forward provisions have been revised. The revisions produce the following results:

**MFPs primarily engaged in municipal securities representative activities:** The two-year look back is retained, and the look forward is reduced to one year.

**Solicitor MFPs:** The two-year look back is retained, but limited only to contributions to officials of the issuer solicited, and the look forward is reduced to one year.

**Supervisor and management-level MFPs:** The look back is reduced to six months and the look forward is reduced to one year.

Dealers are prohibited from engaging in municipal securities business with a municipal securities issuer within two years after any contribution to an official of such issuer made by the dealer, any MFP, or any political action committee controlled by the dealer. A dealer that has triggered the ban may seek an exemption from the appropriate regulatory agency, or, in certain limited circumstances, use an automatic exemption. MSRB Rule G-37 describes relevant factors to be considered by the appropriate regulatory agency in determining whether to grant an exemption.

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See MSRB Notice 2003-25 (June 30, 2003), *Electronic G-37 Submission System (eG-37 System) Becomes Operational* ([www.msrb.org/msrb1/archive/eG-37AnnouncementNotice.htm](http://www.msrb.org/msrb1/archive/eG-37AnnouncementNotice.htm)); and MSRB Notice 2003-17 (May 12, 2003), *SEC Approves Amendments to Rule G-37 Revising the Exemption Process and the Definition of Municipal Finance Professional* ([www1.msrb.org/msrb1/archive/G-37approval503.htm](http://www1.msrb.org/msrb1/archive/G-37approval503.htm)).

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*Qualifications*

Dealers are required to ensure that their supervisors are appropriately qualified for their area of responsibility. The principal who serves as the primary contact for electronic communications from the MSRB must be qualified as a municipal securities principal or a municipal fund securities limited principal. The individual who is directly engaged in the functions of a municipal securities principal in a firm that limits its municipal securities activities to municipal fund securities must be qualified as a municipal securities principal or a municipal fund securities limited principal.

See MSRB Notice 2003-6 (February 28, 2003), *Reminder: To Supervise Municipal Fund Securities Activities, a Municipal Fund Securities Limited Principal (Series 51) or Municipal Securities Principal (Series 53) Qualification is Required by April 1, 2003* ([www1.msrb.org/msrb1/archive/noticeG-3.htm](http://www1.msrb.org/msrb1/archive/noticeG-3.htm)); and MSRB Notice 2003-26 (July 1, 2003), *Notice of Technical Amendments to Form G-40, on E-Mail Contacts* ([www1.msrb.org/msrb1/archive/G-40Revisedform.htm](http://www1.msrb.org/msrb1/archive/G-40Revisedform.htm)).

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*Transaction Reporting*

Broker/dealers have an obligation to report their municipal securities transactions to the MSRB accurately and on time. Transaction information is made available to the public, and to the NASD and other regulators for market surveillance and enforcement activities.

See *NASD Notice to Members 03-13, MSRB Rules G-12 and G-14: NASD Reminds Firms about Transaction Reporting Requirements and Announces Enforcement Actions Against Firms for Violations of MSRB Transaction Reporting Rules G-12 and G-14*; MSRB Notice 2003-7 (March 3, 2003), *Reminder Regarding MSRB Rule G-14, Transaction Reporting Requirements* ([www1.msrb.org/msrb1/archive/TRSnotice0203.htm](http://www1.msrb.org/msrb1/archive/TRSnotice0203.htm)); see also the section on Municipal Price Reporting/Transaction Reporting System on the MSRB Web Site, [www.msrb.org](http://www.msrb.org).

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## Mutual Funds

### *Breakpoints and Share Classes*

Failure to provide customers with appropriate mutual fund discounts is conduct that violates SRO rules. NASD has issued *Special Notice to Members 02-85 (NASD Requires Immediate Member Firm Action Regarding Mutual Fund Purchases and Breakpoint Schedules*, December 2002) and two Investor Alerts regarding mutual funds to make investors aware of share classes and breakpoints. Broker/dealers should remind their associated persons of their obligation to ensure that their clients are charged the lowest possible front-end sales charge. See NASD Investor Alerts: *Class B Mutual Fund Shares: Do They Make the Grade?* ([www.nasdr.com/alert\\_classb\\_funds.htm](http://www.nasdr.com/alert_classb_funds.htm)), dated June 25, 2003; *Mutual Fund Breakpoints: A Break Worth Taking* ([www.nasdr.com/alert\\_breakpoint.htm](http://www.nasdr.com/alert_breakpoint.htm)), and *Understanding Mutual Fund Share Classes* ([www.nasdr.com/alert\\_mfclasses.htm](http://www.nasdr.com/alert_mfclasses.htm)), both dated January 14, 2003.

Note that the *Report of the Joint NASD/Industry Task Force on Breakpoints* ([www.nasdr.com/breakpoints\\_report.asp](http://www.nasdr.com/breakpoints_report.asp), page 15) recommends greater focus on breakpoint rules, terms, and considerations in Firm Element training.

To stay current on this important topic, firms should monitor NASD's Breakpoint Web Site: [www.nasdr.com/breakpoints\\_members.asp](http://www.nasdr.com/breakpoints_members.asp).

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### *Late Trades and Market Timing*

Investment Company Act Rule 22c-1(a) generally requires that redeemable securities of investment companies be sold and redeemed at a price based on the net asset value (NAV) of the fund computed after the receipt of orders to purchase. It is a violation of NASD Rule 2110 (Standards of Commercial Honor and Principles of Trade), and may be a violation of the federal securities laws and NASD Rule 2120 (Use of Manipulative, Deceptive or Other Fraudulent Devices), for member firms and their associated persons to knowingly or recklessly effect mutual fund transactions that are priced based on NAV that is computed prior to the time the order to purchase or redeem was given by the customer. Furthermore, it may be a violation of NASD Rule 2110 and the federal securities laws to knowingly or recklessly facilitate certain mutual fund transactions, such as market timing transactions, in conjunction with, or with the acquiescence of, a mutual fund sponsor, fund administrator, investment adviser, underwriter, or any other affiliated person where those other parties acted contrary to a representation made in the prospectus or statement of additional information pursuant to which the mutual fund shares are offered.

See *NASD Special Notice to Members 03-50, Mutual Fund Transactions: NASD Reminds Member Firms of Their Obligations Regarding Mutual Fund Transactions and Directs Review of Policies and Procedures*, September 2003.

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**Options***Supplement to the  
Options Disclosure  
Document*

The SEC approved the Options Clearing Corporation's supplement to the Options Disclosure Document (ODD) relating to:

- 1) Options on Investment Companies and Similar Entities
- 2) Special Exercise Settlement Procedures or Restrictions that may be imposed upon the occurrence of certain extraordinary events;
- 3) Disclosure that a Registration Statement and Prospectus will no longer be available from the OCC or U.S. options exchanges.

See CBOE Regulatory Circular RG03-12 dated March 5, 2003, *Supplement to the Options Disclosure Document Regarding Exercise Settlement Values*.

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**OTC Equity  
Securities**

On August 22, 2002, the SEC approved new NASD Rule 2315, (Recommendations to Customers in OTC Equity Securities) [Recommendation Rule]. Rule 2315 is intended to address abuses in transactions involving thinly capitalized (microcap) securities. The Rule mandates that a member conduct a due diligence review of an issuer's current financial and business information before recommending that issuer's microcap securities. Since the Rule does not supercede existing member obligations when recommending a security, e.g., suitability determination, compliance with Rule 2315 does not provide a safe harbor from an RR's responsibility to determine the appropriateness of such securities for each prospective customer. See *NASD Notice to Members 02-66, OTC Equity Securities: SEC Approves NASD Rule 2315; Recommendations to Customers in OTC Equity Securities*, October 2002.

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**Outside Business  
Activities and  
Private Securities  
Transactions**

A registered person who sells a security away from his or her firm without first obtaining written approval from the firm violates NASD Rule 3040, and a registered person who engages in an outside business activity without prior notice to his or her firm, including the sale of non-securities products, violates NASD Rule 3030. Registered persons are advised to provide written notice to their firms before they engage in the sale of any financial instrument that is not approved by their firm. NYSE Rule 407 states that associated persons obtain their employers' written approval prior to establishing or monitoring securities or commodities accounts or entry into private securities transactions. See also NYSE Information Memo 02-40, *Amendments To Rule 407 Relating To Private Securities Transactions*, August 28, 2002 ([www.nyse.com](http://www.nyse.com) => *Regulation => Information Memos*).

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SEC-approved amendments to CBOE rules require non-supervisory associated persons who are registered and who engage in outside business activities to provide written notice to the member organization that employs them and receive the member's prior written consent for such outside activities. With respect to persons registered as ROPs, FinOps, or Sales Supervisors of member organizations of which the CBOE is the Designated Examining Authority, such individuals must have prior written authorization from the member firm prior to engaging in any outside business activity. The member firm is also required to provide prompt written notice to the CBOE of any outside business of registered supervisory personnel.

See CBOE Regulatory Circular RG03-37 dated June 9, 2003, *Other Affiliations of Registered Associated Persons*.

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**Principal-  
Protected Funds**

The recent bear market has left many investors worried more about securing the return of their investment dollars than about the return on their investments. Some have turned to new types of mutual funds that pledge to guarantee, for a set period of time, that the capital invested in the mutual fund or in a variable annuity's sub-accounts will be kept safe—for a price. These products are known as "principal-protected" funds (or, alternatively, principal protection, capital preservation, or guaranteed funds). Associated persons should be trained in the features, risks, and suitability of principal-protected funds and explain to their clients how they work and what they cost. See NASD Investor Alert, *Principal-Protected Funds – Security Has a Price*, ([www.nasdr.com/alert\\_principal\\_protected\\_funds.htm](http://www.nasdr.com/alert_principal_protected_funds.htm)), dated March 27, 2003.

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**Registration and  
Reporting  
Requirements**

*Criminal and Civil  
Complaints and  
Arbitration Claims*

On March 3, 2003, the SEC approved a proposal to amend NASD Rule 3070 to require members promptly to file with NASD copies of certain criminal and civil complaints and arbitration claims that name a member or an associated person as defendant or respondent. The amendment requires members promptly to file with NASD copies of the following documents: (1) any criminal complaints filed against the member or plea agreements entered into by the member that are covered by Rule 3070; (2) any securities or commodities-related private civil complaints filed against the member; (3) any arbitration claim against the member; and (4) any criminal complaint or plea agreement, private civil complaint, or arbitration claim against an associated person that is reportable under question 14 on Form U4, irrespective of any dollar threshold requirements that question imposes for notification. See *NASD Notice to Members 03-23, Rule 3070: SEC Approves Amendment to Rule 3070 to Require Filing with NASD of Criminal and Civil*

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*Complaints and Arbitration Claims, May 2003. See also NYSE Information Memos 03-11, Fingerprint Processing And FBI Identification Records, March 25, 2003, and 02-52, New Forms U-4 AND U-5 Filing Procedures Through Web CRD, November 18, 2002 (www.nyse.com) => Regulation => Information Memos).*

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**Research Analysts'  
Conflicts of  
Interest**

On May 10, 2002, the SEC approved new NASD Rule 2711 (Research Analysts and Research Reports), as well as amendments to New York Stock Exchange (NYSE) Rule 351, (Reporting Requirements), and Rule 472, (Communications With The Public). The intent of the new rule and rule amendments is to increase research analysts' independence from influences within their firms and provide disclosure of conflicts of interests that might potentially bias research analysts and the research reports they produce. Generally, the new rule and amendments: 1) restrict the relationship between research and investment banking departments; 2) require disclosure of financial interests in subject companies by analysts and firms; 3) require disclosure of existing and potential investment banking relationships with subject companies; 4) impose quiet periods for the issuance of research reports; 5) restrict personal trading by analysts; and 6) require disclosure of information that assists investors in tracking the correlation between analysts' recommendations and stock price movement.

On July 29, 2003, the SEC approved further amendments to these rules. The amendments are the latest in a series of joint regulatory efforts intended to address broker/dealer and analyst conflicts of interest and to enhance public disclosure of such potential conflicts of interest. The amendments also amend NASD/NYSE rules to comply with the mandates of the Sarbanes-Oxley Act of 2002, and impose registration, qualification, and continuing education requirements on research analysts. When the amendments to SRO Continuing Education Rules become effective in 2004, research analysts will be required to be registered and will be subject to the Regulatory Element and the Firm Element. Firm Element training for research analysts and their immediate supervisors will be required to include ethics, professional responsibility, and the requirements of new Research Analyst rules, e.g., NASD Rule 2711.

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See *NASD Notice to Members 03-44: Research Analysts and Research Reports*, August 2003; NYSE Information Memos 03-36, *Amendments to Disclosure and Reporting Requirements*, August 25, 2003; 03-30, *RULE 472 - Gatekeeper Requirements*, July 10, 2003; 03-12, *April 1st Reporting Requirement - Rules 351 & 472*, March 25, 2003; *Disclosure and Reporting Requirements Nos 02-55*, November 29, 2002, and 02-30, July 9, 2002 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

See also *NASD Notice to Members 02-39: SEC Approves Rule Governing Research Analysts' Conflicts of Interest*, July 2002; and *SEC Regulation Analyst Certifications (Reg AC)* at [www.sec.gov/rules/final/33-8193.htm](http://www.sec.gov/rules/final/33-8193.htm).

NASD maintains a Web Site on this evolving topic that is continuously updated at [www.nasdr.com/analyst\\_guide.htm](http://www.nasdr.com/analyst_guide.htm)

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**Security Futures  
(also know as  
Single Stock  
Futures)**

The Commodity Futures Modernization Act of 2000 lifted the ban on the trading of security futures (*i.e.*, futures on narrow-based indices, single stocks, and options on securities futures). Because security futures have different characteristics and requirements than existing securities, the SROs have adopted rules that require any currently registered securities professional that intends to engage in a security futures business or to supervise such activity to complete a training program covering security futures, which may be included as Firm Element training for the pertinent registered persons. The SROs have also developed a content outline for use in the development of the training program, which focuses on the essential information individuals and supervisors should know before conducting a securities futures business. The content outline has five modules:

- 1) Stocks and Stock Options
- 2) Futures Contracts
- 3) Security Futures
- 4) Regulatory Requirements for Security Futures
- 5) Supervision of the Offer and Sale of Security Futures.

An individual's current registration category will determine which of these modules must be completed before engaging in a security futures business. Series 7 registrants, for example, may not need to participate in the training on Stocks and Stock Options. Therefore, a member firm must consider the registration category and qualifications of persons in determining the nature and scope of his or her training.

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Firms may develop their own securities futures training program or may engage a third party provider to deliver the training program, so long as the training provided encompasses all appropriate subjects in the SRO-developed content outline. Firms remain responsible for compliance with SRO rules in all respects where training is developed and or administered by outside parties. NASD and the NFA have developed a Web-based security futures training program that, if completed in the prescribed manner, would satisfy the required training requirement. Information regarding this training program can be obtained at [www.nasdr.com/futures.asp](http://www.nasdr.com/futures.asp). Note: Securities and futures SROs are in the process of developing regulatory requirements for the registration and qualification of persons engaged in security futures contracts sales and supervision activities. Please monitor the NASD Web Site and these other SRO Web sites for additional information: [www.nfa.futures.org](http://www.nfa.futures.org), [www.nyse.com](http://www.nyse.com), and [www.amextrader.com](http://www.amextrader.com).

Broker/dealers need to maintain records of the completion of any security futures training program designed to satisfy the requirement. Members may be required during an examination or investigation to demonstrate that individuals who are engaged in a security futures business have completed the required training.

For more information on security futures in general, please see: [www.nqix.com](http://www.nqix.com) and [www.onechicago.com](http://www.onechicago.com).

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## **Supervision**

### *Books and Records*

Branch office managers and other supervisory personnel, as well as RRs, should be aware of SEC-approved amendments to the broker/dealer Books and Records Rules, Rule 17a-3 and Rule 17a-4 under the Securities Exchange Act of 1934, that became effective on May 2, 2003. The amendments clarify and expand recordkeeping requirements in connection with purchase and sale documents, customer records, associated person records, customer complaint records, and certain other matters. The amendments also require broker/dealers to maintain or promptly produce certain records at each office to which those records relate.

Some of the more significant aspects of the Books and Records Rules are:

- ◆ The definition of "office."
- ◆ Updating Customer Account Records.
- ◆ Additional Information Annotated on Order Tickets.
- ◆ Additional Records Related to Associated Persons.
- ◆ Retention of Communications With the Public.

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For more information, see NASD's Books and Records Web Site at [www.nasdr.com/books.asp](http://www.nasdr.com/books.asp), which has links to the following: *SEC Interpretive Release: Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, Rel. 34-47910 (5/29/03)*; *NASD Notice to Members 01-80, Books and Records Rules: Amendments To Broker/Dealer Books And Records Rules Under The Securities Exchange Act Of 1934*, December 2001; and Frequently Asked Questions.

See also NYSE Information Memos 03-18, *I. Amended Rule 36, (Communications Between Exchange And Members' Offices) – Cell Phones, And Requirements For Conducting A Public Business II. Clarification Of Recent SEC Books And Records Rules*, May 6, 2003, and 03-16, *Effective Date For "Books And Records" Rule Amendments*, April 15, 2003 ([www.nyse.com](http://www.nyse.com) => Regulation => Information Memos).

Also see CBOE Regulatory Circular RG03-032 dated May 2, 2003, *Effective Date for "Books and Records" Rule Amendments*, and PHLX Membership Memo 0551-03 dated May 5, 2003, *Amendments to Broker-Dealer Books and Records Rules*.

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General Topics

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Industry continuing education rules require a broker/dealer to include supervisory training for supervisors if its Firm Element Needs Analysis establishes the need for it. Supervisors should be trained on new rules with general application, e.g., anti-money laundering, as well as new rules relating to new products, if applicable. Firms should reiterate with supervisors the importance of internal controls as they relate to areas such as changing customer addresses, Letters of Authorization, mail directed to customer post office boxes, time and price discretionary orders, and supervision of producing managers.

Broker/dealers may also find it helpful to periodically review with their supervisors various examples of conduct that violates SRO rules, such as:

- ◆ Exercising Discretion Without Prior Written Authority
- ◆ Failure to Respond to SRO Information Requests
- ◆ Failure to Provide Customers With Mutual Fund Breakpoints
- ◆ Falsifying Documents
- ◆ Forgery
- ◆ Misrepresentations to Customers
- ◆ Selling Away
- ◆ Unsuitable Recommendations
- ◆ Unauthorized Trading

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Supervisors in turn may wish to share this information with the registered persons they supervise. Many industry SROs publish information on their Web sites that illustrate improper conduct and the disciplinary action taken by regulators. For example: NASD's quarterly *Disciplinary Update* at [www.nasdr.com/disc\\_update\\_index.asp](http://www.nasdr.com/disc_update_index.asp), and NYSE's Disciplinary Actions at [www.nyse.com/regulations.html](http://www.nyse.com/regulations.html).

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### *Instant Messaging*

Instant messaging is a developing technology that can pose supervisory and recordkeeping challenges for member firms. Instant Messaging's lack of formality does not exempt it from the general standards applicable to all forms of communication with the public. Broker/dealers must supervise the use of instant messaging consistent with the required supervision of e-mail messaging. Depending on the circumstances, instant messaging could be either sales literature or correspondence. Compliance in each of these situations depends on clear supervision and review procedures that are consistently followed. If a member is unable to establish an adequate supervisory program, the member must prohibit the use of instant messaging in customer communication. Broker/dealers must also ensure that their use of instant messaging complies with applicable SEC and SRO recordkeeping requirements. See *NASD Notice to Members 03-33, Instant Messaging: Clarification for Members Regarding Supervisory Obligations and Recordkeeping Requirements for Instant Messaging*, July 2003.

Also, broker/dealers are required pursuant to NYSE Rule 440 and SEC Rules 17a-3 and 17a-4 to retain records that relate to the conduct of their business. Instant messaging, while a new format for communications, is subject to the same retention requirements as any other form of written or electronic communications. See Information Memo 03-7, *Electronic Logs And Record Retention*, March 5, 2003 ([www.nyse.com](http://www.nyse.com) => *Regulation* => *Information Memos*).

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## Variable Annuities and Life Insurance

Associated persons should be trained in the features, risks, and suitability of variable annuity and life insurance contract exchanges so as to assist their clients in making informed decisions. NASD has published a number of Investor Alerts on this subject:

- ♦ *Should You Exchange Your Variable Annuity?*  
([www.nasdr.com/alert\\_annuityexchanges.htm](http://www.nasdr.com/alert_annuityexchanges.htm))  
February 15, 2001
- ♦ *Should You Exchange Your Life Insurance Policy?*  
([www.nasdr.com/alert\\_exchange\\_lifeinsurance.htm](http://www.nasdr.com/alert_exchange_lifeinsurance.htm))  
September 23, 2002
- ♦ *Variable Annuities: Beyond the Hard Sell,*  
([www.nasdr.com/alert\\_variable\\_annuities.htm](http://www.nasdr.com/alert_variable_annuities.htm))  
May 27, 2003

See also *NASD Notice to Members 99-35, The NASD Reminds Members of Their Responsibilities Regarding the Sale of Variable Annuities*, May 1999; and *Variable Annuities: What You Should Know*, at [www.sec.gov/consumer/varannty.htm](http://www.sec.gov/consumer/varannty.htm).

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## To Obtain More Information

For more information about publications contact the SROs at these addresses:

<b>Self-Regulatory Organization</b>	<b>Address and Phone Number</b>	<b>Online Address</b>
American Stock Exchange	American Stock Exchange Marketing Department 86 Trinity Place New York, NY 10006 800-THE-AMEX	<a href="http://www.amex.com">www.amex.com</a> <a href="http://www.amextrader.com">www.amextrader.com</a>
Chicago Board Options Exchange	Chicago Board Options Exchange 400 S. LaSalle Street Chicago, IL 60605 877-843-2263 e-mail: <a href="mailto:help@cboe.com">help@cboe.com</a>	<a href="http://www.cboe.com">www.cboe.com</a>
Municipal Securities Rulemaking Board	MSRB Publications Department 1900 Duke Street Suite 600 Alexandria, VA 22314 703-797-6600	<a href="http://www.msrb.org">www.msrb.org</a>
NASD	NASD MediaSource P.O. Box 9403 Gaithersburg, MD 20898-9403 240-386-4200	<a href="http://www.nasd.com">www.nasd.com</a>
New York Stock Exchange	New York Stock Exchange Publications Department 11 Wall Street 18th Floor New York, NY 10005 212-656-5273 or 212-656-2089	<a href="http://www.nyse.com">www.nyse.com</a>
Philadelphia Stock Exchange	Philadelphia Stock Exchange Marketing Department 1900 Market Street Philadelphia, PA 19103 800-THE PHLX or 215-496-5158	<a href="http://www.phlx.com">www.phlx.com</a>

# Notice to Members

SEPTEMBER 2003

## SUGGESTED ROUTING

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

## KEY TOPICS

Debt Securities  
Dissemination  
Operations  
Rule 6200 Series  
Transaction Reporting

INFORMATIONAL

## Corporate Debt Securities Transaction Reporting

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

### Executive Summary

NASD requires members to report corporate debt securities transactions to NASD and subjects transaction information of certain categories of securities to dissemination pursuant to the Trade Reporting and Compliance Engine (TRACE) rules (TRACE Rules). In this *Notice to Members*, NASD provides guidance on frequently asked questions concerning the reporting of debt securities when par value is not a standard amount and the resubmission of rejected TRACE trade reports under the new 45-minute reporting requirement.

### Questions/Further Information

Questions concerning this *Notice* may be directed to [tracefeedback@nasd.com](mailto:tracefeedback@nasd.com); Elliot Levine, Chief Counsel, Market Operations, Regulatory Services and Operations, at (202) 728-8405; or, Sharon K. Zackula, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985.

### Interpretive Guidance

Questions and Answers 1 through 5 address how a member reports bond quantities when the bond traded has a non-standard par value (a par value other than \$1,000 per bond). Question and Answer 6 address the resubmission of rejected trade reports under the new 45-minute reporting requirement, and the rescission of prior guidance on this subject.

03-58

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## Questions and Answers

**Q1. How do I report a baby bond (less than \$1,000 face value per bond)?**

A1. Enter the amount in decimal form. Examples: 1/2 a bond = ".50"; a \$512.37 piece of a bond = ".51237."

**Q2. How do I report quantity for a bond with a pro-rata sinking fund that has a factor?**

A2. The TRACE Rules and the TRACE System include the assumption that one bond is equal to \$1,000 par value. Therefore, the quantity for bonds that involves a factor must be translated into a percentage of \$1,000. Reporting quantity for bonds involving a factor is the same as reporting quantity for a baby bond.

Example: A broker/dealer buys or sells 25 bonds with a pro-rata sinking fund for which the current factor is .300. To determine the quantity for reporting to TRACE, multiply 25 by .300 for a quantity of 7.5 bonds. This results in a remaining principal amount of \$7,500 (at this point in the sinking fund schedule), instead of the original \$25,000.

**Q3. How do I report quantity on bonds with par values greater than \$1,000? (Note that two exceptions, GMAC 0 12/1/12 and GMAC 0 6/15/15, are addressed in No. 4)**

A3. As noted above, the TRACE Rules and TRACE System assume that one bond has a standard par value, which is \$1,000. When this is not true, and the bond traded has a par value greater than \$1,000, the total par value traded must be translated into \$1,000 equivalents.

Examples:

A bond has a par value of \$2,500. If 20 bonds are bought or sold, the total par value is \$50,000. Divide \$50,000 by \$1,000. Quantity reported to TRACE = 50.

A bond has a par value of \$500,000. If 10 bonds are bought or sold, the total par value is \$5,000,000. Divide by \$1,000. Quantity reported to TRACE = 5,000.

**Q4. How do I report quantity and price for GMAC 0 12/1/12 and GMAC 0 6/15/15? These issues trade on the NYSE in units and in prices expressed in hundreds rather than in bond dollars (representing a percentage of par). If I execute OTC, however, how do I report quantity, price, and yield into TRACE?**

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- A4. Both the GMAC 0 12/1/12, CUSIP 370424CZ4 (Symbol GMAC.GC) and the GMAC 0 6/15/15 CUSIP 370424DA8 (Symbol GMAC.GD) are exceptions to the norm for reporting to TRACE, since firms may hold these securities differently on their stock records and price can also be expressed in multiple ways. Firms typically settle these trades ex-clearing, with settlement necessitating that both parties use the same standards.

Both issues have par values greater than \$1,000 and a final maturity value of \$10,000. On the New York Stock Exchange (NYSE), both issues are traded in units: one unit = \$10,000. For example, if one unit having a maturity value of \$10,000 trades for a contracted value of \$4,950, a price of \$495 for a quantity of one unit (or one tenth of the contract amount) would be reported to the NYSE. To arrive at the same yield that is posted on the NYSE, market participants can perform a zero-coupon calculation using a workaround solution of entering a dollar price of 49.50 (moving the decimal place an additional place to the left, or one hundredth of the contract amount), which “resembles” bond dollars.

In order to accommodate reporting of these two bonds, the TRACE System adopts the same workaround solution for the calculation of yield to maturity, based upon a “bond-like” price (a price under \$100). The TRACE System assumes a \$1,000 par value; hence, reporting a quantity of one (unit) would be disseminated as \$1,000, which would be both incorrect and misleading. Therefore, since each security trades in increments of \$10,000, the reporting party should report a quantity of 10 for each unit traded. When the transaction information is disseminated, the quantity will appear as 10,000. Report yield to maturity (YTM) only.

Firms executing OTC transactions in either of these issues should submit their TRACE reports according to the example below. Firms reporting through third-party intermediaries should make sure that they can support this methodology; otherwise, reporting will have to be accomplished manually. When reporting through NSCC, the entry should be submitted using a zero-coupon price (e.g., less than 100) and a quantity 10 times the number of units traded (rather than the contract amount). The entry should be marked as a “reporting only” report, so that it will not flow through NSCC’s comparison system. Any possible submissions to NSCC for comparison in these securities should be done separately from the TRACE transaction report.

Example:

One (1) unit is bought, having a maturity value of \$10,000. Reported quantity = 10 and reported price = 49.50. YTM is determined from this price, using the zero-coupon calculation. When disseminated, the quantity reported of one unit will appear as 10,000 traded at 49.50 with the corresponding YTM. (To report the purchase of 4 units, report a quantity of 40.)

Note: Report to TRACE YTM only.

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**Q5. How do I report commissions for the securities GMAC 0 12/1/12 and GMAC 0 06/15/15, referenced above?**

- A5. Commissions in fractions of a point: Because the maturity value of each unit is \$10,000, one point = \$100, rather than the norm of one point = \$10 for a bond with a \$1,000 principal value at maturity. If the commission charged to the customer in the purchase or sale of GMAC 0 12/1/12 or GMAC 0 06/15/15 is one-eighth of a point (.125), this represents \$12.50 per each \$10,000 maturity value. In this example, the member would report .125 in the commission field. If, for example, the price of one unit traded is \$4,950 (on the NYSE, \$495), on TRACE, the price reported is 49.50. Add or subtract the one-eighth of a point (.125) (depending upon whether you sold or bought) to/from the price that will be used to calculate the yield. If selling, the all-inclusive price would be 49.625 (49.50 + .125), with yield to maturity (YTM) calculated from this price. If buying, the all-in price would be 49.375 (49.50 – .125), with YTM calculated from this price.

Flat-fee commissions: If the commission charged to the customer on two units of \$10,000 is \$50, and the price of one unit is \$4,950 (on the NYSE, \$495), then the price reported to TRACE is 49.50, and the commission is reported as .25. If selling, add .25 to 49.50 and calculate YTM from an all-in price of 49.75. If buying, subtract .25 from 49.50, which results in an all-in price of 49.25 with which to calculate YTM.

**Q6. When the new TRACE 45-minute reporting period becomes effective, how much time does a member have to resubmit a trade report that was rejected?**

- A6. As of October 1, 2003, the period to report a transaction to TRACE will be reduced from 75 minutes to 45 minutes.<sup>1</sup> As a result, NASD is issuing new guidance, effective as of 8:00 a.m. Eastern Time on October 20, 2003, regarding the resubmission of rejected trade reports, and is withdrawing the guidance issued in NtM 02-76 (November 2002), Question and Answer No. 1 (Q & A 1).<sup>2</sup> The guidance issued in NTM 02-76, Q & A 1, is withdrawn as of 8:00 a.m. Eastern Time on October 20, 2003, and, after that time, members should not rely on it.

The period to report a transaction in a TRACE-eligible security will be reduced from 75 minutes to 45 minutes effective October 1, 2003. NASD recognizes, however, that some members may be using a reporting technology that does not immediately relay a message to the member that a transaction report has been rejected. Thus, members may be unaware for a substantial part of the 45-minute reporting period that they must resubmit the trade report.<sup>3</sup> Accordingly, in these circumstances, as a general rule, NASD expects that members will correct and resubmit rejected trade reports as soon as practicable, but not later than 90 minutes from the time of execution. (This generally applicable interpretive guidance is referred to hereinafter as the “45-Minute Extension.”)

However, there are three scenarios when a member may not rely on the 45-Minute Extension. The three scenarios are set forth below.

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- a. If a member executes a trade less than 45 minutes before the closing of the TRACE System (on or after 5:45:01 p.m. Eastern Time through 6:29:59 p.m. Eastern Time),<sup>4</sup> under Rule 6230(a)(1), the member has the option to report the transaction to TRACE the same day, or the next day that the TRACE System is open, within 45 minutes of the opening. In both of these scenarios, a member is not entitled to rely on the 45-Minute Extension to comply with the obligation to timely report.
- i. No Extension of Time Applies: If the member reports the transaction to TRACE before the TRACE System closes and the transaction report is rejected, the member must report the transaction the next day the TRACE System is open, within the first 45 minutes that the System is open in order for the report to be timely. *The 45-Minute Extension does not apply in these circumstances.* For example, a member executes a transaction at 6:10 p.m. Eastern Time on Thursday, the member reports the transaction at 6:29 p.m. Eastern Time, and the transaction report is rejected. On Friday morning, the member must resubmit the corrected transaction report within the first 45 minutes that the TRACE System is open for the report to be timely.
- ii. Fifteen-Minute Extension: If the member opts to first file the transaction report on the next business day that the TRACE System is open, and the transaction report is rejected, the member must correct and resubmit the transaction report as soon as possible and not later than one hour after the TRACE System opens. Stated another way, *the member has 45 minutes to report the transaction and is granted an additional 15 minutes to comply with its reporting obligation. The 45-Minute Extension does not apply in these circumstances.* For example, a member executes a trade at 6:10 p.m. Eastern Time on Thursday, the member first reports the trade on Friday at 8:05 a.m. Eastern Time, and the report is rejected. The member must correct and resubmit the transaction report not later than 8:59:59 a.m. Eastern Time in order for the report to be considered timely filed. The 15-minute extension of time to report is appropriate because members have had time to prepare the transaction report, and should attempt to report outstanding transactions promptly after the TRACE System opens.
- b. Fifteen-Minute Extension: If a member executes a trade when the TRACE System is closed (e.g., on or after 6:30 p.m. Eastern Time on a business day that the TRACE System was open, during a weekend or a holiday, or before 8:00 a.m. Eastern Time on a business day that the TRACE System will open), the member is required under Rule 6230(a)(2) through (4) to report the transaction the first day that the TRACE System is open, within 45 minutes. If the transaction report is rejected, the member must correct and resubmit a transaction report as soon as possible, but not later than one hour after the TRACE System opens. *In this case also, the member has 45 minutes to report the transaction and is granted only an additional 15 minutes to comply with its reporting obligation. In addition, the 45-Minute Extension does not apply.* For example, a member executes a trade at 7:00 p.m. Eastern Time on Thursday. The TRACE System is closed until Friday at 8:00 a.m. Eastern Time. The member first reports the trade on Friday at 8:05 a.m. Eastern Time, and the report is rejected. The member must correct and

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resubmit the trade report not later than 8:59:59 a.m. Eastern Time to report on time. The member is permitted to use only an additional 15 minutes to report for the same reasons expressed above.

Regardless of the reporting mechanism used by the member (e.g., batch submission, CTCI, Web browser, third party intermediary reporting systems), any rejected trade reports should be corrected and resubmitted to TRACE as soon as possible by the reporting member. NASD will continue to monitor members' reporting to ensure that members have procedures in place that are reasonably designed to ensure that rejected trade reports are identified, corrected, and resubmitted in a timely manner. Patterns and practices of late submissions due to rejections may be considered a violation of the TRACE Rules and Rule 2110.

## Endnotes

- 1 See NtM 03-36 (June 2003).
- 2 Q & A 1 allowed a member, in certain extenuating circumstances, to resubmit rejected trade reports that were "high priority" reports as soon as practicable, but not later than 2 and 1/2 hours after the time of execution of the transaction, and allowed a member to correct and resubmit a "low priority" report as soon as practicable, but not later than the end of the reporting day on the day of execution (or the first business day following the day of execution, if the transaction occurred on a non-business day). High-priority reports were defined as reports of transactions in securities that are subject to dissemination under Rule 6250. Reports of transactions in securities not subject to dissemination under Rule 6250 were low-priority reports. In this guidance, NASD has eliminated these two categories.
- 3 Certain members are using technology that reports transactions to and receives verification of accepted reports back from TRACE via a "batch" process, and this batch process may add time to the identification and correction of trade reports initially rejected by the TRACE System.
- 4 The normal schedule for TRACE System operations is 8:00 a.m. Eastern Time through 6:29:59 p.m. Eastern Time. The times are provided as an example. The actual times may vary if the TRACE System is not operating on a normal schedule.

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# Disciplinary and Other NASD Actions

## REPORTED FOR SEPTEMBER

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 August 2003.

### Firms Expelled, Individuals Sanctioned

**Liss Financial Services (CRD #21950, Milwaukee, Wisconsin) and Jerome Edward Liss (CRD #310709, Registered Representative, Belgium, Wisconsin)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was expelled from NASD membership and Liss was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that, in connection with the offer and sale of a security, they engaged in a series of transactions with the issuer and with affiliates of the issuer that operated as a scheme to evade the registration provisions of the Securities Act of 1933. NASD found that the firm and Liss served as statutory underwriters for the issuer in violation of Section 5 of the Securities Act of 1933 by acquiring unregistered shares from the issuer and from control affiliates of the issuer by means of a gypsy swap transaction, distributing those shares to the public without registration or valid exemption, and returning the proceeds of the distribution to the issuer. The findings also stated that the firm and Liss effected transactions for customer accounts in the securities of a penny stock without providing customers with the disclosure required under Section 15g of the Exchange Act and Rules 15g-2 and 15g-3 thereunder. Specifically, NASD found that the respondents failed to furnish customers with risk disclosure documents relating to the penny stock market before effecting customer transactions; failed to obtain from customers a manually signed and dated written statement acknowledging receipt of the risk disclosure document before effecting customer transactions in the company securities; and failed to disclose to customers and to confirm in writing the bid and ask price of the stock before effecting customer transactions in the stock. In addition, NASD found that the firm and Liss failed to respond to NASD requests for documents and information. Furthermore, NASD determined that the firm failed to reasonably supervise the activities of employees, and failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with securities laws, regulations, and NASD rules. **(NASD Case #CMS030167)**

**SFI Investments, Inc. (CRD #21663, New York, New York) and Frank Joseph Fasano (CRD #1003292, Registered Principal, Summit, New Jersey)**. The firm was expelled from NASD membership and Fasano was barred from association with any NASD member in any capacity. In light of the expulsion and bar, as well as the financial status of Fasano, no monetary sanctions were imposed. The sanctions were based on findings that the firm, acting through traders and with Fasano's acquiescence and approval, improperly used public customer accounts as the firm's

de facto accounts for proprietary trading in municipal securities in violation of its restriction agreement with NASD. The findings also stated that the firm, acting through Fasano, engaged in a securities business while failing to maintain the net capital required by the Securities and Exchange Commission (SEC). NASD also found that the firm and Fasano allowed individuals to function as general securities representatives without having registered with NASD and failed to exercise reasonable supervision over them. In addition, NASD found that the firm failed to respond to NASD requests for information in a timely manner. (NASD Case #C10970176)

## Firms Fined, Individuals Sanctioned

**Banyan Capital Markets, LLC (CRD #45763, Boca Raton, Florida) and Barry Fredric Goldberg (CRD #3096483, Registered Principal, Boca Raton, Florida)** were fined \$10,000, jointly and severally. The firm was also censured and Goldberg was fined \$20,000, individually, and suspended from association with any NASD member in any capacity for 45 days. The fines must be paid before Goldberg reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, the firm and Goldberg consented to the described sanctions and to the entry of findings that the firm and Banyan produced a research report evaluating a public company that was unbalanced, unwarranted, and contained omissions of material fact concerning the company. The findings also stated that the report failed to disclose that the company might be required to issue securities to satisfy current debt, thereby diluting previously issued stock. NASD also found that the firm, through Goldberg, failed to supervise adequately the work of a registered representative in preparing the report. In addition, NASD found that the report failed to disclose in the written agreement that the firm would be compensated by the company for the services of the representative, and that the compensation was to be received by the firm.

Goldberg's suspension began July 16, 2003, and concluded at the close of business August 29, 2003. (NASD Case CAF030035)

**Blackwood Securities, LLC (CRD #44669, New York, New York) and Craig Robert Schlifstein (CRD #2637134, Registered Representative, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$105,000, \$20,000 of which is joint and several with Schlifstein. Schlifstein was suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Schlifstein, failed to submit required information to the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>) on 506 consecutive business days, and submitted to OATS reports with respect to equity securities traded on The

Nasdaq Stock Market that were not in the electronic form prescribed by NASD. The findings stated that the reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web Site, but the firm did not correct or replace any of the subject reports.

NASD also found that the firm, acting through Schlifstein, transmitted to OATS reports that contained inaccurate, incomplete, or improperly formatted data, executed a short-sale transaction in a Nasdaq National Market<sup>®</sup> (NNM<sup>®</sup>) security at or below the current inside bid when the current inside bid was below the preceding inside bid in the security, and executed short-sale orders and failed to make an affirmative determination prior to executing such transactions. Furthermore, the firm, acting through Schlifstein, failed to respond timely and/or completely to NASD requests for information. In addition, the findings stated that the firm, acting through Schlifstein, failed to keep current and amend Schlifstein's application for registration, and the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations concerning the bid test rule, the affirmative determination rule, and the OATS reporting rules.

Schlifstein's suspension began August 18, 2003, and concluded at the close of business August 29, 2003. (NASD Case #CMS030168)

**Institutional Equity Corporation f/k/a Redstone Securities, Inc. (CRD #19628, Dallas, Texas) and Robert Alton Shuey, III (CRD #710362, Registered Principal, Dallas, Texas)** were fined \$20,000, jointly and severally, and Shuey was suspended from association with any NASD member in any capacity for one year. The sanctions were based on findings that the firm, acting through Shuey, failed to deposit funds of best efforts minimum-maximum offerings in bona fide escrow accounts, as represented in the offering memoranda. The findings also stated that the firm, acting through Shuey, utilized the instrumentalities of interstate commerce to engage in a securities business while failing to maintain its required minimum net capital and filed FOCUS reports that inaccurately stated the firm's net capital. In addition, the findings stated that the firm, acting through Shuey, failed to prepare and maintain accurate books and records.

Shuey's suspension began July 21, 2003, and will conclude at the close of business July 20, 2004. (NASD Case #C06020018)

**Phillip Louis Trading, Incorporated (CRD #19378, Red Bank, New Jersey) and Johnny Philip Figliolini, Jr. (CRD #1058617, Registered Principal, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$44,000, including disgorgement of \$14,036.31 in commissions received. Figliolini was fined \$10,000, suspended from association with any NASD member in any capacity for 10 business days, and ordered to requalify by exam for the Series 24 license before acting again in a principal

capacity. Without admitting or denying the allegations, the firm and Figliolini consented to the described sanctions and to the entry of findings that an agent of the firm effected the sale of unregistered shares of stock to market makers while the firm engaged in the distribution of the stock to market makers and acted as an underwriter as defined in Section 2(11) of the Securities Act of 1933. The findings also stated that the firm allowed individuals to exercise discretion in the accounts of public customers without receiving prior written authorization from the customers, and that the firm did not accept the accounts in writing as discretionary. NASD found that Figliolini failed to supervise the activities of an individual in the sale of unregistered securities and failed to respond to red flags and inquire as to the source of the stocks and the relationships between account holders. In addition, NASD found that the firm failed to institute a supervisory system and establish and maintain written supervisory procedures reasonably designed to achieve compliance with federal securities laws, regulations, and NASD rules regarding restricted securities.

Figliolini's suspension began August 18, 2003, and concluded at the close of business August 29, 2003. (NASD Case #CAF030036)

## Firm and Individual Fined

Tripp & Company, Inc. (CRD #6967, New York, New York) and Kevin Michael John O'Connor (CRD #1096256, Registered Principal, Port Chester, New York) submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$12,500, jointly and severally. Without admitting or denying the allegations, the firm and O'Connor consented to the described sanctions and to the entry of findings that the firm, acting through Tripp, operated without a registered financial and operations principal. The findings also stated that the firm, acting through O'Connor, failed to maintain accurate books and records. (NASD Case #C10030062)

## Firms Fined

Automated Trading Desk Brokerage Services, LLC (CRD #36000, Mt. Pleasant, South Carolina) 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 executed short-sale transactions in NNM securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. In addition, 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 the reporting of short-sale transactions to NASD. (NASD Case #CMS030162)

Clayton, Williams & Sherwood Investments (CRD #23551, Newport Beach, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it permitted registered persons to act in capacities requiring registration while their NASD registrations were inactive due to failure to complete in a timely manner the Regulatory Element of the Continuing Education Requirement. (NASD Case #C02030043)

Investment Placement Group (CRD #14458, La Jolla, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it effected transactions in stock option contracts that resulted in the firm's customers holding or controlling an aggregate equity options position that exceeded the applicable options position limits. The findings also stated that the firm did not follow the procedures set forth in its written supervisory procedures that direct a designated supervisor to identify positions that exceed allowable option position limits under the rules of self-regulatory organizations, and thus failed to establish, maintain, and enforce a supervisory system that was reasonably designed to achieve compliance with NASD Rule 2860(b)(3). (NASD Case #CMS030164)

Seaboard Securities, Inc. (BD #755, Florham Park, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$12,500, and required, within 30 days of acceptance of this AWC, to retain at its sole expense, an independent outside consultant not unacceptable to NASD to conduct a review of and prepare a written report and make recommendations as to the adequacy of the firm's supervisory and compliance policies and procedures and its system for applying such procedures. Without admitting or denying the allegations, the firm consented to the described sanctions and to entry of findings that it failed to timely amend certain Forms U4 and U5 of registered representatives of a branch office after becoming aware of information triggering an obligation to amend these Forms, such as the filing of reportable customer complaints and arbitration claims. NASD also found that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to ensure that Forms U4 and U5 were promptly amended upon receipt of information triggering an obligation to amend. (NASD Case #C9B030049)

Tanager Capital Group LLC (BD #111972, Maplewood, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it conducted securities and investment banking activities prior to

the approval of the firm's membership with NASD. (NASD Case #C9B030048)

**United Securities Alliance, Inc. (BD #36487, Greenwood Village, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$111,425. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that registered persons failed to take the Regulatory Element of Continuing Education within their respective windows and subsequently became inactive; and, while inactive, the firm allowed them to engage in activities that required registration, and they generated and were paid transaction-based compensation. NASD found that the firm allowed registered persons not to participate in the firm Element of Continuing Education. The findings also stated that the firm failed to report, or was delinquent in reporting, occurrences that required reporting under Rule 3070 and failed to conduct annual inspections of offices of supervisory jurisdiction. In addition, NASD determined that the firm failed to register off-site locations such as branch offices with NASD, and that the firm could only provide evidence that 157 of the firm's 1,130 registered persons attended an annual compliance meeting in 2000. The findings also stated that the firm failed to perform the requisite background check on 17 new hires, and, in addition, failed to obtain the Form U5 from the previous employer of five of the new hires. NASD also found that the firm failed to promptly notify NASD of branch office address changes and that the firm's written supervisory procedures and supervisory system were inadequate. (NASD Case #C3A030032)

**vFinance Investments, Inc. (CRD #44962, Boca Raton, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$17,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short-sale transactions in a NNM security and failed to report each of these transactions to the Automated Confirmation Transaction Service (ACT<sup>SM</sup>) with a short-sale modifier. The findings stated that the firm executed short-sale orders in NNM securities and failed to make an affirmative determination prior to executing such transactions. NASD also found that the firm executed short-sale transactions in NNM securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. In addition, 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 short sales. (NASD Case #CMS030177)

## Individuals Barred or Suspended

**Fulvio Antonio Acosta, Jr. (CRD #2857206, Registered Representative, Philadelphia, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was

fined \$5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Acosta reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Acosta consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transfers within a public customer's variable annuity without the customer's prior knowledge, consent, and authorization.

Acosta's suspension began August 18, 2003, and will conclude at the close of business November 17, 2003. (NASD Case #C10030061)

**Joseph Ali (CRD #3063988, Associated Person, 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, Ali consented to the described sanction and to the entry of findings that he forged the signatures of public customers on a Third Party Full Discretionary Authorization form that provided Ali with power of attorney and authorized him to exercise control over the funds in the customers' account at his member firm. The findings also stated that Ali wired \$23,000 from the account of public customers at his member firm to his personal bank account and converted the funds for his own use and benefit, without the customers' knowledge, authorization, or consent. NASD also found that Ali falsely testified about the conversion during an NASD on-the-record interview. (NASD Case #C10030057)

**Frank Joseph Argenziano (CRD #1933781, Registered Principal, Massapequa, New York)** submitted an Offer of Settlement in which he was fined \$25,000 and suspended from association with any NASD member in any capacity for 15 business days. Without admitting or denying the allegations, Argenziano consented to the described sanctions and to the entry of findings that he engaged in the sale of an initial public offering (IPO) of common shares and warrants to public customers and misrepresented the structure of the IPO, and created an improper tie-in by instructing the firm's brokers to solicit the offering securities to public customers as a unit only when, in fact, the Registration Statement filed with the SEC provided that common shares and warrants could be purchased separately. The findings also stated that Argenziano engaged in unauthorized customer 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 all of the customers to firm up the IPO purchases. NASD also found that Argenziano caused the clearing firm to create and mail inaccurate transaction confirmations to public customers that failed to disclose the actual number of IPO shares and warrants purchased by the customers and reflected an unauthorized purchase of a unit IPO security. In addition, NASD found that Argenziano caused his firm to maintain inaccurate books and records by entering a "dummy" automatic data

processing 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 occurred.

Argenziano's suspension began August 18, 2003, and concluded at the close of business September 8, 2003. (NASD Case #CAF030009)

**Samuel Shmuel Barmapov (CRD #4245309, Registered Representative, Staten Island, 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, Barmapov consented to the described sanction and to the entry of findings that he recommended and sold to public customers shares of stock in two obscure, low-priced, highly speculative companies. The findings stated that, in recommending these stocks, Barmapov misrepresented the financial prospects of the companies and made baseless price predictions. In addition, NASD found that Barmapov failed to disclose the risks of investing in these speculative stocks and omitted material facts concerning the financial conditions of the companies. Further, the respondent's recommendations of these stocks were unsuitable for the customers. (NASD Case #CMS030157)

**Val U. Barrutia (CRD #1020898, Registered Principal, Colorado Springs, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Barrutia consented to the described sanction and to the entry of findings that he received \$794,886 from public customers for the purpose of purchasing securities, but converted these funds for his own use and benefit without the customer's prior knowledge, authorization, or consent. (NASD Case #C3A030034)

**Wendell Duane Belden (CRD #1324913, Registered Principal, Tulsa, Oklahoma)** was fined \$40,000, required to pay \$55,567.03, plus interest, in restitution to the estate of a public customer, suspended from association with any NASD member in any capacity for one year, and ordered to requalify by exam as a principal before functioning in any principal capacity. The SEC affirmed the sanctions following an appeal of a National Adjudicatory Council (NAC) decision. The sanctions were based on findings that Belden made unsuitable recommendations to a public customer by recommending Class B mutual fund shares instead of Class A shares in order to receive higher commissions.

Belden's suspension began August 18, 2003, and will conclude at the close of business August 17, 2004. (NASD Case #C05010012)

**Rick Louis Bradley (CRD #4368588, Registered Representative, Dubuque, Iowa)** 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, Bradley consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form U4 and failed to respond to NASD requests for information. (NASD Case #C04030039)

**Barbara Lynch Brandenburg (CRD #28824, Registered Principal, Dallas, Texas)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Brandenburg caused checks totaling \$79,000 to be issued from the accounts of public customers held at her member firm, without the knowledge or consent of the firm or the account holders, endorsed each check with the names of the customers, and deposited the checks into an account under her control. The findings also stated that Brandenburg failed to respond to NASD requests for information. (NASD Case #C05030009)

**Richard Edward Casner (CRD #2932269, Registered Representative, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Casner consented to the described sanction and to the entry of findings that he conducted unauthorized transactions in the account of a public customer without the customer's prior knowledge, authorization, or consent. The findings stated that after the customer complained to Casner that she had not authorized the transactions, he attempted to settle the complaint by depositing the amount of losses generated by the unauthorized transactions into the customer's account and did not disclose the customer's complaint or the fact that he had deposited funds into the customer's account to his member firm. NASD also found that Casner failed to respond to NASD requests for information. (NASD Case #C06030016)

**Douglas Paul Cataldo (CRD #2467839, Registered Representative, Lynn, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Cataldo consented to the described sanction and to the entry of findings that he converted a public customer's funds. (NASD Case #C11030024)

**James Jay Christiano (CRD #2747068, Registered Principal, Jericho, New York)** was fined \$50,000 and suspended from association with any NASD member in any capacity for two years. The sanctions were based on findings that Christiano failed to testify truthfully during an NASD on-the-record interview.

Christiano's suspension began July 21, 2003, and will conclude at the close of business July 20, 2005. (NASD Case C10990158)

**Austin Charles Cogswell (CRD #600615, Registered Representative, Atlanta, Georgia)** 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, Cogswell consented to the described sanction and to the entry of findings that he participated in numerous private securities transactions, for compensation, without providing his member firm prior written notice of his intent to participate in the transactions, without obtaining his firm's approval in writing, and without having the transactions supervised by his member firm and carried on its books and records. The findings also stated that Cogswell participated in outside business activities without providing his member firm prompt written notice of his activity. (NASD Case #C07030052)

**John Francis Collopy, Jr. (CRD #51410, Registered Principal, Miami, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$6,000, jointly and severally, and suspended from association with any NASD member in a financial and operations principal capacity for five business days. Without admitting or denying the allegations, Collopy consented to the described sanctions and to the entry of findings that a member firm, acting through Collopy, conducted a securities business while failing to maintain the required net capital under Securities Exchange Act Rule 15c3-1.

Collopy's suspension began September 2, 2003, and concluded at the close of business September 8, 2003. (NASD Case #C07030051)

**John Marvin Cook, II (CRD #1900910, Registered Representative, Miami Beach, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Cook failed to respond to an NASD request to appear for an on-the-record interview. (NASD Case #CMS030016)

**John Michael Curran (CRD #1576877, Registered Principal, Dallas, Texas), Douglas Matthew Kent (CRD #2584392, Registered Principal, Arlington, Texas), and Mitchell Seth Rosenthal (CRD #1084558, Registered Principal, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which Curran was fined \$5,000 and suspended from association with any NASD member in any principal capacity for 30 business days. Kent was barred from association with any NASD member in any capacity and Rosenthal was fined \$7,500 and suspended from association with any NASD member in any principal capacity for 30 business days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Kent, who was responsible for conducting proprietary trading on behalf of his member firm, placed transactions that belonged in the firm's

proprietary trading account into the IRA account of Rosenthal in order to conceal trading losses in the proprietary account, resulting in trading losses of \$16,530 in Rosenthal's account. The findings stated that Kent conducted unauthorized transactions in his firm's error account and concealed his trading activity by, among other things, entering fictitious trades to offset the unauthorized trades and entering fictitious prices for executed transactions and canceling executed transactions. NASD also found that Rosenthal learned of Kent's activities, failed to take any remedial action against Kent, and failed to notify the firm's chief supervisory officer of Kent's activities. Furthermore, the findings stated that Rosenthal and Curran, on behalf of their member firm, failed to act in a manner reasonably calculated to prevent Kent from violating applicable securities laws, regulations, and NASD rules.

Curran's suspension began August 18, 2003, and will conclude at the close of business September 29, 2003. Rosenthal's suspension began August 18, 2003, and will conclude at the close of business September 29, 2003. (NASD Case #C06030014)

**Luis Felipe Diaz, Jr. (CRD #2539595, Registered Representative, Setauket, New York)** was fined \$30,000 and suspended from association with any NASD member in any capacity for 90 days. The fine must be paid upon Diaz' reentry into the securities business. The sanctions were based on findings that Diaz made misrepresentations to public customers regarding risks associated with investments in variable annuity contracts.

Diaz' suspension began July 21, 2003, and will conclude October 18, 2003. (NASD Case #CLI030002)

**Lawrence Richard Dugo (CRD #2555823, Registered Representative, Farmingdale, 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, Dugo consented to the described sanction and to the entry of findings that he recommended and sold to public customers two obscure, low-priced, highly speculative securities. The findings stated that, in recommending the securities, Dugo misrepresented the financial prospects of the companies and made baseless price predictions, failed to disclose the risks of investing in these speculative stocks, and omitted material facts concerning the companies' financial conditions. In addition, NASD found that Dugo recommended stocks to public customers for whom the stocks were unsuitable. (NASD Case #CMS030174)

**John Mann Ellsworth (CRD #1748107, Registered Principal, Salt Lake City, 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, Ellsworth consented to the described sanction and to the entry of findings that he converted \$196,000 from the account of a public customer for his own use and benefit

without the customer's prior knowledge, authorization, or consent. (NASD Case #C3A030031)

**William Brian Fazio (CRD #4087019, Registered Principal, Milwaukee, Wisconsin)** 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, Fazio consented to the described sanctions and to the entry of findings that he recommended the purchase of securities to public customers of his member firm without reasonable grounds for believing that such investments were suitable in light of the customers' security holdings, financial situation, and needs.

Fazio's suspension began July 15, 2003, and concluded at the close of business July 28, 2003. (NASD Case #CMS030166)

**Morty Paul Forney (CRD #1076472, Registered Principal, Billings, Montana)** 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, Forney consented to the described sanction and to the entry of findings that he obtained checks from a public customer totaling \$149,295.25 intended for the purchase of securities. NASD found that, without the knowledge or consent of the customer, Forney deposited the funds in his personal bank account, thereby converting the customer's funds to his own use and benefit. (NASD Case #C3B030011)

**Randall Joseph Frey (CRD #3212391, Registered Representative, North Royalton, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 10 business days. In light of the financial status of Frey, the fine imposed was \$2,500. Without admitting or denying the allegations, Frey consented to the described sanctions and to the entry of findings that he exercised discretion to effect transactions in the accounts of a public customer pursuant to verbal authority without prior written authorization from the customer and prior written acceptance of the account as discretionary by his member firm.

Frey's suspension began August 18, 2003, and concluded at the close of business August 29, 2003. (NASD Case #C8B030015)

**Herbert Amos Jones, Jr. (CRD #2614626, Registered Principal, Pittsburg, California)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Jones instructed a public customer to write a \$10,000 check made payable to him to be invested for the sole and exclusive benefit of the customer and, instead, without the customer's knowledge or consent, Jones negotiated the check

and used the funds for his personal benefit or for some purpose other than the benefit of the customer. NASD also found that Jones failed to respond to NASD requests for information. (NASD Case #C01030007)

**David Christopher Kane (CRD #4514246, Registered Representative, New Baltimore, Michigan)** submitted an Offer of Settlement in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Kane reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Kane consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Form U4.

Kane's suspension began August 18, 2003, and will conclude at the close of business February 17, 2004. (NASD Case #C8A030021)

**John M. Klukewycz (CRD #2477332, Registered Representative, Forest Hills, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Klukewycz failed to respond to NASD requests for information. (NASD Case #CMS030050)

**Maurice Thomas Larrea (CRD #3041830, Registered Representative, Houston, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Larrea consented to the described sanction and to the entry of findings that he provided to a public customer correspondence in the form of a letter signed by him containing the false and misleading representation that his member firm guaranteed a balance in the amount of \$410,000 in the customer's account. The findings also stated that Larrea failed and neglected to obtain approval of the correspondence from a principal at his member firm when he knew, or should have known, that approval of outgoing correspondence was required pursuant to the rules of NASD. (NASD Case #C05030037)

**David Scott Leggett (CRD #1949697, Registered Principal, Louisville, Colorado)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Leggett reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Leggett consented to the described sanctions and to the entry of findings that he received and accepted securities from public customers to be held in safekeeping. NASD found that Leggett failed to promptly deliver the public customers' securities to his member firm's main office for deposit into the customers' accounts. The finding also stated

that Leggett signed a Securities Pledge Agreement on behalf of his member firm between his customer and a third party, committing his member firm to certain commitments and undertakings. NASD also found that Leggett was not authorized to sign the Securities Pledge Agreement on behalf of his member firm.

Leggett's suspension began August 4, 2003, and will conclude at the close of business August 3, 2005. (NASD Case #C3A030029)

**Matthew Nguyen Littauer (CRD #2027330, Registered Principal, Central Hong Kong, China)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Littauer consented to the described sanctions and to the entry of findings that he allowed a member firm to open new customer accounts using his representative number with the firm for public customers whose new accounts were solicited by persons not registered with the firm. The findings also stated that Littauer allowed the firm to use his representative number on transactions for public customers that were solicited by persons not registered with the firm and who provided the firm with instructions for the transactions. NASD also found that the firm did not have written authorization from the customer that was approved by a principal of the firm, authorizing the firm to accept the trade authorization from the unregistered person, and Littauer failed to speak with the customers about the transactions prior to their execution. Furthermore, NASD found that Littauer's actions of allowing the firm to use his registered representative number in this manner caused the firm to create and maintain inaccurate books and records reflecting that Littauer was the registered representative for the customers who solicited the new accounts and transactions.

Littauer's suspension began August 18, 2003, and will conclude at the close of business September 17, 2003. (NASD Case #CAF030037)

**Martin Owen McCann, IV (CRD #2455442, Registered Principal, Fresno, California)** submitted an Offer of Settlement in which he was fined \$38,841.21, including \$34,841.21 in compensation received by McCann, and suspended from association with any NASD member in any capacity for five months. The fine must be paid before McCann reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, McCann consented to the described sanctions and to the entry of findings that he participated in outside business activity without providing prompt written notification to this member firm.

McCann's suspension began August 18, 2003, and will conclude January 17, 2004. (NASD Case #C01030002)

**Alexys Ulando McKenzie (CRD #2642827, Registered Principal, Head of Harbour, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$25,000, suspended from association with any NASD member in any capacity for two weeks, and ordered to pay \$78,575.53 in restitution to public customers. Without admitting or denying the allegations, McKenzie consented to the described sanctions and to the entry of findings that he charged excessive commissions and mark-downs on agency or principal transactions in highly liquid securities resulting in \$507,062.50 in commissions and mark-ups. The findings also stated that McKenzie failed to take into account the factors identified in NASD Conduct Rule IM-2440 in determining the fairness of commissions or mark-ups.

McKenzie's suspension began September 2, 2003, and will conclude at the close of business September 15, 2003. (NASD Case #CAF030040)

**Kelli O'Brien Milz (CRD #2956890, Registered Principal, Marietta, Georgia)** submitted an Offer of Settlement in which she was fined \$20,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Milz reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Milz consented to the described sanctions and to the entry of findings that she aided and abetted unregistered broker/dealer activity by opening new accounts at her member firm for individuals from new account forms provided by a non-registered day-trading firm with Milz as the registered representative on the forms. Once the new accounts had been opened, the customers were able to trade electronically using the software and trading platforms provided by the non-registered firm. The findings also stated that Milz paid, or caused to be paid, transaction-based compensation to the non-registered firm that then made transaction-based payments to other unregistered persons and entities. NASD also found that Milz created a customer account system that allowed an unregistered individual to track commissions due to the non-registered firm. In addition, NASD found that Milz assisted in the preparation of Web sites that promoted unregistered brokerage services.

Milz' suspension began August 18, 2003, and will conclude at the close of business August 17, 2005. (NASD Case #CAF020067)

**Charlie J. Montero, Jr. (CRD #1789058, Registered Representative, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for 30 days. In light of the financial status of Montero, no monetary sanctions were imposed. Without admitting or denying the allegations, Montero consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form U4.

Montero's suspension began August 18, 2003, and will conclude at the close of business September 16, 2003. (NASD Case #C10030055)

**Joseph Michael Mucci (CRD #2566913, Registered Representative, Matawan, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, ordered to disgorge \$6,412.39 in commissions in partial restitution to a public customer, and suspended from association with any NASD member in any capacity for six months. The fine and restitution must be paid before Mucci reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Mucci consented to the described sanctions and to the entry of findings that he exercised control over the account of a public customer and effected numerous and excessive securities transactions in this account, using unsuitable levels of margin in a manner that was inconsistent with the customer's investment objectives.

Mucci's suspension began September 2, 2003, and will conclude at the close of business March 1, 2004. (NASD Case #C9B030053)

**Aqiyl Taariq Muhammed (CRD #2379364, Registered Representative, Marietta, Georgia)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for 120 days. In light of the financial status of Muhammed, no monetary sanctions were imposed. Without admitting or denying the allegations, Muhammed consented to the described sanction and to the entry of findings that he opened an investment club at his member firm and solicited public customers to transfer \$258,263.05 from their existing securities accounts at his member firm to the investment club to be pooled for investment. The findings also stated that Muhammed entered into a "limited joint venture agreement" pursuant to which he obligated the club to invest \$350,000 without conducting any investigation to determine the potential risks of the joint venture prior to entering into the agreement and without having an adequate and reasonable basis for believing that the joint venture was suitable for investment prior to entering into the joint venture agreement. NASD also found that Muhammed entered into the agreement and failed to provide prior written notice to, and receive prior written approval from, his member firm to participate in the joint venture.

Muhammed's suspension began September 2, 2003, and will conclude at the close of business December 30, 2003. (NASD Case #C07030035)

**Jeffrey Murray Nadel (CRD #1589564, Registered Representative, Norwalk, Connecticut)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, including disgorgement of \$1,900 of commissions, suspended from association with any NASD member in any capacity for six

months, and required to pay \$43,625, plus interest, in restitution to a public customer. The fine and restitution must be paid before Nadel reassociates with a member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Nadel consented to the described sanctions and to the entry of findings that he recommended that a public customer sell certain equity and mutual fund positions in the customer's account and purchase shares of a speculative security that resulted in the customer's account being highly concentrated in that security, thereby causing the account to suffer losses.

Nadel's suspension began September 2, 2003, and will conclude at the close of business March 1, 2004. (NASD Case #C11030027)

**Peter Christopher Orthos (CRD #2079337, Registered Principal, Manhasset, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500, jointly and severally, and suspended from association with any NASD member as a general securities principal for 15 months. Without admitting or denying the allegations, Orthos consented to the described sanctions and to the entry of findings that a member firm, acting through Orthos, failed to supervise adequately the activities of a former registered representative of the firm who engaged in excessive trading, unsuitable recommendations, and unauthorized transactions in the accounts of public customers.

Orthos' suspension began August 18, 2003, and will conclude at the close of business November 17, 2004. (NASD Case #C10030060)

**Anthony A. Phillips (CRD #4501026, Associated Person, Sacramento, 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, Phillips consented to the described sanction and to the entry of findings that he failed to disclose a material fact on his Form U4. The findings also stated that Phillips failed to respond to NASD requests for information. (NASD Case #C01030017)

**Robert William Phillips (CRD #2216889, Registered Principal, Spring Valley, 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, Phillips consented to the described sanction and to the entry of findings that he effected, or caused to be effected, transactions in the securities accounts of public customers and exercised discretionary power in those accounts without having obtained the customers' written authorization and/or prior written authorization from his member firm to treat the accounts as discretionary. The findings also stated that Phillips recommended and engaged in transactions in the securities accounts of public customers

without having reasonable grounds for believing that his recommendations and resultant transactions were suitable for the customers on the basis of their financial situations, investment objectives, and needs. (NASD Case #C02030045)

**David Jullian Piusienski (CRD #4300924, Registered Representative, Cohoes, 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, Piusienski consented to the described sanction and to the entry of findings that he misappropriated insurance premiums totaling \$2,320 from public customers. (NASD Case #C11030025)

**Patrick Albert Quigley (CRD #2567031, Registered Representative, Tucson, Arizona)** 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, Quigley consented to the described sanction and to the entry of findings that he converted \$4,991 received from a public customer for his own use and benefit without the customer's prior knowledge, authorization, or consent. NASD also found that Quigley settled a customer's complaint by signing a promissory note agreeing to pay the customer \$43,432.30 without informing his member firm. (NASD Case #C3A030030)

**Eugene Francis Raia (CRD #1365986, Registered Principal, Montville, 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, Raia consented to the described sanction and to the entry of findings that he appeared before NASD staff for an on-the-record interview and refused to answer any questions. (NASD Case #C9B030047)

**Kenneth Mitchell Robinson (CRD #2110219, Associated Person, Charlotte, North Carolina)** 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, Robinson consented to the described sanction and to the entry of findings that he converted approximately \$2,200 in public customer funds to his own use without authorization. (NASD Case #C07030047)

**Philip Lawrence Salice (CRD #2928448, Registered Representative, Bayshore, 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, Salice consented to the described sanction and to the entry of findings that he failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #CMS030169)

**Ian Jon Scott (CRD #2962358, Registered Representative, Cedarburg, Wisconsin)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member in any capacity for 31 days, suspended from association with any NASD member as a general securities principal for nine months, and required to requalify by exam as a general securities principal within six months. Without admitting or denying the allegations, Scott consented to the described sanctions and to the entry of findings that he failed to supervise reasonably the activities of employees of his member firm, and failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with securities laws, regulations, and NASD rules. The findings also stated that Scott failed to reasonably supervise and establish and maintain an adequate supervisory system with regard to investment banking activities, including the public and private offer, sale, and distribution of securities; fair pricing of securities; communications with the public; customer suitability; and penny stock disclosure requirements.

Scott's suspensions began August 1, 2003, and the suspension in any capacity concluded August 31, 2003; the suspension as a general securities principal will conclude at the close of business April 30, 2004. (NASD Case #CMS030165)

**Rory James Skifton (CRD #3080208, Registered Representative, La Crosse, Wisconsin)** 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, Skifton consented to the described sanction and to the entry of findings that he converted a money order belonging to a public customer to his personal use or for some purpose other than the customer's benefit. (NASD Case #C8A030060)

**Gloster Knox Sonia (CRD #1802577, Registered Representative, New Orleans, Louisiana)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Sonia failed to respond to NASD requests for information. NASD also found that Sonia participated in private securities transactions without prior written notice to, and approval from, his member firm. (NASD Case #C05030007)

**Edward Roosevelt Tiller (CRD #2608325, Registered Representative, Piscataway, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500, ordered to pay \$7,500 in partial restitution to a customer, and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Tiller consented to the described sanctions and to the entry of findings that he recommended that a customer invest his lump-sum distribution in a variable annuity but did not have reasonable grounds for believing that

the recommendation and resulting transaction were suitable for the customer on the basis of the customer's financial situation, investment objections, and needs.

Tiller's suspension began September 2, 2003, and will conclude at the close of business September 15, 2003. (NASD Case #C9B030052)

**Dennis Lee Thompson, II (CRD #1429850, Registered Principal, Lafayette, Louisiana)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, including \$1,837.79 in disgorgement of commissions earned, and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Thompson consented to the described sanctions and to the entry of findings that he recommended and effected the sale of deferred variable annuity contracts to a public customer without having a reasonable basis for believing that the recommendations and sales were suitable for the customer.

Thompson's suspension began September 15, 2003, and will conclude at the close of business September 26, 2003. (NASD Case #C05030039)

**Arthur Andrew Toth, III (CRD #2518656, Registered Principal, Pittsburgh, Pennsylvania)** was barred from association with any NASD member in any capacity and ordered to pay \$8,455, plus interest, in restitution to public customers. The sanctions were based on findings that Toth solicited and induced public customers to purchase warrants by means of high-pressure sales tactics, material omissions of fact and risk, and baseless and unreasonable price predictions. The findings also stated that Toth failed to disclose to public customers the material, negative information publicly available about the issuers of warrants and the securities. (NASD Case #CAF020023.

**Mark Alan Uselton (CRD #2229571, Registered Principal, Edmond, Oklahoma)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500, suspended from association with any NASD member in the capacity of financial and operations principal for six months, and suspended from association with any NASD member in the capacity of general securities principal for three months. Without admitting or denying the allegations, Uselton consented to the described sanctions and to the entry of findings that, acting on behalf of his member firm, he engaged in a securities business when the firm's net capital was below the required minimum in contravention of SEC Rule 15c3-1. The findings also stated that Uselton, acting on behalf of his member firm, failed and neglected to provide notification that his member firm's net capital was below the required minimum pursuant to SEC Rule 15c3-1. In addition, the findings stated that Uselton, acting on behalf of his member firm, failed and neglected to file an accurate FOCUS Part IIA report and to timely file its annual

audited financial statement report within 60 days. NASD also found that Uselton failed to maintain copies of the firm's general ledger and month-end trial balances.

Uselton's suspensions began August 18, 2003, and his suspension as a general securities principal will conclude at the close of business November 17, 2003; his suspension as a financial and operations principal will conclude at the close of business February 17, 2004. (NASD Case #C05030035)

**Anthony Vincent Vitale (CRD #2623131, Registered Representative, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for 20 business days. Without admitting or denying the allegations, Vitale consented to the described sanctions and to the entry of findings that he failed, within 90 seconds after execution, to transmit through ACT last-sale reports of block transactions in an Over-the-Counter (OTC) Equity security. The findings stated that, in connection with the block transactions, Vitale's member firm acted in a principal capacity and he intentionally delayed reporting the block transactions so that he, on behalf of member firm, could effect trades in securities that offset, in whole or in part, the position his member firm held as a result of the respective block transactions. NASD determined that by so delaying the trade reports, Vitale minimized the risk his member firm faced in connection with the block transactions.

Vitale's suspension began August 4, 2003, and concluded at the close of business August 29, 2003. (NASD Case #CMS030178)

**Gabe P. Weinert (CRD #4620877, Registered Representative, Grosse Pointe, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500, suspended from association with any NASD member in any capacity for six months, and required to re-qualify by exam before associating with any NASD member firm in any capacity. The fine must be paid before Weinert reassociates with a member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Weinert consented to the described sanctions and to the entry of findings that, prior to taking the Series 7 exam, he signed a document that prohibited him from leaving the testing center and from removing any materials from the testing center, and that advised him that any violation of such rules was subject to possible disciplinary action. The findings stated that during the exam, Weinert left the testing center on two occasions and took at least one piece of scratch paper with him.

Weinert's suspension began August 18, 2003, and will conclude at the close of business on February 17, 2004. (NASD Case #C8A030058)

**Frank Lenord Wilson, Jr. (CRD #4160225, Registered Representative, Delafield, Wisconsin)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Wilson took blank checks from the checkbook of a registered representative of his member firm. The findings also stated that Wilson made the checks, totaling \$4,000, payable to himself, forged the registered representative's signature on the checks, endorsed the checks, and used the funds for his own benefit or for the benefit of someone other than the registered representative. NASD also found that Wilson attempted to misappropriate an additional \$1,855.45 from the registered representative, which was stopped when the representative discovered that the check was missing. In addition, the findings stated that Wilson failed to respond to NASD requests for information. **(NASD Case #C8A030010)**

## Individuals Fined

**Christopher Joseph Cox (CRD #2723225, Registered Principal, Baldwin, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$10,000. Without admitting or denying the allegations, Cox consented to the described sanctions and to the entry of findings that he failed to establish, maintain, and enforce special procedures for supervising the telemarketing activities of all of his member firm's registered representatives as required by NASD's Taping Rule. The findings also stated that Cox allowed the registered representatives in the firm's main office and branch offices to have control over the firm's taping system, therefore failing to ensure the tape recording of all telephone conversations between the firm's registered persons and existing and potential public customers. NASD also found that the firm was only taping conversations of three registered representatives and not the remaining six registered representatives. In addition, NASD found that Cox failed to ensure that all tape recordings were retained for a period of not less than three years from the date the tape was created, the first two years in an easily accessible place, and failed to catalogue all of the retained tapes by registered person and date. **(NASD Case #C10030064)**

**Vladimir Eydelman (CRD #2697580, Registered Representative, Long Beach, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured, fined \$10,000, and ordered to pay \$23,845.65 in restitution to public customers. Without admitting or denying the allegations, Eydelman consented to the described sanctions and to the entry of findings that he charged excessive commissions and mark-downs on agency or principal transactions in highly liquid securities that resulted in \$102,500 in commissions and mark-downs. The findings also stated that Eydelman failed to take into account the factors identified in NASD Conduct Rule IM-2440 in determining the fairness of mark-ups and mark-downs when establishing the amount of the commission or mark-down. **(NASD Case #CAF030041)**

## Decisions Issued

The following decisions have been issued by the DBCC or the Office or Hearing Officers and have been appealed to or called for review by the NAC as of August 1, 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 *Notices to Members*.

**Brookes McIntosh Bendetsen (CRD #1374304, Registered Principal, Burlingame, California)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Bendetsen signed the name of a public customer to a margin agreement for the customer's trust account. The findings also stated that Bendetsen recommended to a public customer and effected in the customer's account short sales and purchases of shares of stock and the writing of a series of purchases and sales of option contracts, without having a reasonable basis for believing that the transactions were suitable for the customer based on the facts disclosed by the customer as to other security holdings, financial situation, and needs. NASD also found that Bendetsen created and provided to a public customer false account statements relating to the customer's account at his member firm.

Bendetsen has appealed this decision to the NAC, and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #C01020025)**

**Andrew Christopher Knight (CRD #3011465, Registered Representative, Port Chester, New York)** was fined \$2,500 and suspended from association with any NASD member in any capacity for 30 business days. The sanctions were based on findings that Knight willfully failed to disclose material information on his Form U4.

This decision has been called for review by the NAC, and the sanctions are not in effect pending consideration of the review. **(NASD Case #C10020060)**

**Ronney Arun Sahai (CRD #1551326, Registered Principal, Ridgewood, New Jersey)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Sahai forged, or caused to be forged, the signatures of public customers on documents pertaining to investments. The findings also stated that Sahai engaged in unauthorized transactions on behalf of a public customer. In addition, Sahai failed to respond to NASD requests for information.

Sahai has appealed this decision to the NAC, and the sanctions are not in effect pending consideration of the review. **(NASD Case #C9B020032)**

## 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.

**Raymond Blake Gibson (CRD #3035781, Registered Representative, Raleigh, North Carolina)** was named as a respondent in an NASD complaint alleging that he received in excess of \$34,000 from insurance policyholders for premium payments and converted the funds to his own use without authorization. The complaint also alleges that Gibson failed to respond to NASD requests for information. (NASD Case #C07030049)

**Mia H. Gilchrist (CRD #2894991, Registered Representative, Mount Laurel, New Jersey)** was named as a respondent in an NASD complaint alleging that she submitted to her member firm the purported request of a public customer to change the address of record for the account of the customer, without the customer's authorization. The complaint also alleges that Gilchrist, without the authorization or knowledge of a public customer, caused money market funds in the account of the customer to be liquidated and a check in the amount of \$3,232.04 to be issued and sent to the new address of record for the account. In addition, the complaint alleges that Gilchrist falsified, or caused to be falsified, the purported endorsement of the customer on the check, and caused it to be deposited to the securities account of another customer. The complaint further alleges that Gilchrist failed to respond to NASD requests for information. (NASD Case #C9A030026)

**Stratos Hatzikontos (CRD #2599724, Registered Representative, Fresh Meadows, New York)** was named as a respondent in an NASD complaint alleging that he recommended public customers invest in a company represented as a bona fide company when, in fact, it was fictitious, and received \$40,000 from the customers for the investment. The complaint also alleges that Hatzikontos misappropriated the funds for his own use and benefit. In addition, the complaint alleges that Hatzikontos prepared, or caused to be prepared, and issued false and fictitious account statements to the public customers that purported to represent the performance of their investment in the fictitious company. Furthermore, the complaint alleges that Hatzikontos failed to respond to NASD requests for information and documentation. (NASD Case #C10030065)

**James Paul Hood (CRD #4467331, Registered Representative, Forth Worth, Texas)** was named as a respondent in an NASD complaint alleging that he assisted a public customer in opening a new bank account at the parent

company of his member firm and, without the customer's knowledge or consent, issued ATM cards on the customer's account and began making unauthorized withdrawals on the same day the account was opened. The complaint also alleges that Hood authorized automatic bank drafts by several of his creditors to pay his personal expenses and bills. Furthermore, the complaint alleges that Hood caused \$19,380.91 to be withdrawn from the customer's account without the customer's authorization, knowledge, or consent. In addition, the complaint alleges that Hood failed to respond to NASD requests for information. (NASD Case #C06030017)

**Kirlin Securities, Inc. (CRD #21210, Syosset, New York), Paul Thomas Garvey (CRD #1214388, Registered Representative, Orinda, California), and Brian Francis McEnery (CRD #2735200, Registered Representative, San Francisco, California)** were named as respondents in an NASD complaint alleging that they charged excessive commissions or mark-downs on principal or agency transactions in highly liquid securities. The complaint also alleges that the firm's registered representatives, including Garvey and McEnery, determined the amount to be charged on each of the transactions and knew, or should have known, the relevant factors enumerated in NASD Conduct Rule IM-2440 and should have considered them in determining the fairness of the charges. In addition, the complaint alleges that the charges on the transactions were excessive in light of the type of securities involved, the availability of the securities in the market, the price of the securities, the amount of money involved in the transactions, disclosures to the customer, the pattern of charges, and the nature of the firm's business. Moreover, the complaint alleges that the firm failed to maintain and enforce a supervisory system reasonably designed to achieve compliance with NASD rules relating to charges to customers. Furthermore, the complaint alleges that the firm's written procedures did not include the factors enumerated in Conduct Rule IM-2440, and, one year later, the written procedures reflected the enumerated factors but failed to explain how the factors should be taken into account. (NASD Case #CAF030039)

**Legend Merchant Group, Inc., f/k/a IAR Securities Corp. (CRD #5155, New York, New York) and Edward Andrew Sita (CRD #1509735, Registered Principal, Staten Island, New York)** were named as respondents in an NASD complaint alleging that the firm, acting through Sita, in connection with an inducement or an attempt to induce the purchase or sale of a security or with the offer, sale, and purchase of a security, and through means or instrumentalities of interstate commerce or of the mails, knowingly or recklessly employed a device, scheme, contrivance, and artifice to defraud and manipulative, deceptive, or other fraudulent device or contrivance; omitted to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading; and engaged in acts, practices, or courses of business that operate as a fraud or deceit upon investors, or prospective investors, of a private placement. The complaint also

alleges that the firm, acting through Sita, made a material misrepresentation in a private placement memorandum (PPM) that stated that the firm had no material restriction and/or limitations on its ability to participate in private placements when, in fact, NASD did not permit the firm to participate in private placement offerings until a later date when NASD approved the firm's request for a modification of its membership agreement. In addition, the complaint alleges that the firm, acting through Sita, failed to disclose material facts in the PPM or in the PPM Supplement and knew, or should have known, that omissions in the PPM and the PPM Supplement were material. Furthermore, the complaint alleges that the firm, acting through Sita, participated in a private offering even though the firm's membership agreement did not permit the firm to engage in such activities. (NASD Case #C10030058)

**Chris Michael Manettas (CRD #2274927, Registered Representative, East Quogue, New York)** was named as a respondent in an NASD complaint alleging that he effected, or caused to be effected, transactions in the accounts of public customers that were excessive in frequency in view of the customers' financial circumstances and investment needs. The complaint also alleges that Manettas engaged in this trading activity without reasonable grounds for believing that the level of activity was suitable for the customers based upon the customers' financial situation and investment needs. In addition, the complaint alleges that Manettas purchased large numbers of shares of speculative technology securities on margin in the accounts of public customers that were incompatible with the customers' financial situation. Moreover, the complaint alleges that Manettas effected, or caused to be effected, sales in the accounts of public customers without their knowledge, authorization, or consent. Furthermore, the complaint alleges that Manettas exercised discretion in the accounts of public customers without the prior written authorization of the customers or the prior written acceptance of the account as discretionary by his member firm. (NASD Case #C10030059)

**Matityahu Meshizahav (CRD #2834481, Registered Representative, Brooklyn, New York)** was named as a respondent in an NASD complaint alleging that he withdrew \$20,500 from the account of a public customer and converted the funds to his own use and benefit without the customer's authorization. The complaint also alleges that Meshizahav failed to respond to NASD requests for a written statement, documentation, and information. (NASD Case #C10030063)

**Michael Bernard O'Hare (CRD #2522972, Registered Representative, Bridgewater, New Jersey)** was named as a respondent in an NASD complaint alleging that he recommended and effected purchase and sale transactions in the account of a public customer without having reasonable grounds for believing that such transactions were suitable for the customer in view of the size, frequency, and concentration of the speculative securities; the nature of the recommended transactions; and the customer's financial situation, investment objectives, circumstances, and needs. (NASD Case #C9B030045)

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

National Capital, LLC  
Oklahoma City, Oklahoma  
(July 21, 2003)

**Firm Expelled for Failure to File Annual Audit Reports Pursuant to NASD Rule 9544**

Werbel-Roth Securities, Inc.  
Boca Raton, Florida  
(July 15, 2003)

**Firm Suspended for Failure to Supply Financial Information**

The following firm was suspended from membership in NASD for failure to comply with formal written requests to submit financial information to NASD. The action was based on the provisions of NASD Rule 8221. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

Fuerst Securities Corporation  
Grand Junction, Colorado  
(June 23, 2003)

**Suspension Lifted**

NASD has lifted the suspension from membership on the date shown for the following firm because it has complied with formal written requests to submit financial information.

Oakdale Financial Group LLC  
New York, New York  
(June 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.)

Fearn, Kevin M.  
Delaware, Ohio  
(July 30, 2003)

Yen, Don Joe  
Dallas, Texas  
(July 29, 2003)

Marsh, Jr., Willie T.  
Buffalo, New York  
(July 14, 2003)

Young, Ernest  
Chicago, Illinois  
(July 16, 2003)

Shain, Russell  
Brooklyn, New York  
(July 28, 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.)

Berkman, Jay  
Weston, Connecticut  
(July 14, 2003)

Hafen, Roy  
Las Vegas, Nevada  
(June 12, 2003)

Coulter, Conrad L.  
Newport Beach, California  
(July 10, 2003)

Reardon, Michael D.  
Jasper, Georgia  
(July 14, 2003)

Daly, Paul M.  
Highland Beach, Florida  
(July 29, 2003)

Smith, Jr., James L.  
Jackson, Tennessee  
(July 23, 2003)

Emslie, Patrick  
Tucson, Arizona  
(July 23, 2003)

Sullivan, Frank  
Patchogue, New York  
(July 2, 2003)

Fischer, Francois  
Valley Stream, New York  
(July 25, 2003)

Szilagyi, Melissa M.  
Brookfield, Illinois  
(July 1, 2003)

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

Garceran, Carlos Antonio  
Mendham, New Jersey  
(June 27, 2003)

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

Avery, Leroy  
West Allis, Wisconsin  
(July 21, 2003)

Perez, Raul D.  
Hollywood, Florida  
(July 21, 2003)

Bialecki, Jay A.  
Sunbury, Ohio  
(July 21, 2003)

Richardson, Jeffrey A.  
Columbus, Ohio  
(July 21, 2003)

Donnerstag, Harold P.  
Matawan, New Jersey  
(July 9, 2003)

Stein, Jack H.  
W. Palm Beach, Florida  
(July 21, 2003)

Gallagher, William J.  
Glendale, California  
(July 21, 2003)

Worrell, Kevin D.  
Queens Village, New York  
(July 9, 2003)

Kao, Coleman  
Pasadena, California  
(July 21, 2003)

## NASD Files Enforcement Actions Involving Unsuitable Sales of Mutual Funds

NASD has announced five new enforcement actions as part of its ongoing focus on the sale of Class B mutual fund shares. Four of these cases are settlements in which the individuals agreed to suspensions from the securities industry for up to nine months, and fines totaling almost \$120,000. The fifth action is a complaint where the broker is contesting the charges.

In each of the settled cases, the brokers violated NASD's suitability rule by recommending their customers purchase of B share mutual funds instead of A shares. The purchase of A shares would have eliminated or reduced front-end sales charges through breakpoint discounts available at various dollar amounts; resulted lower ongoing expenses than those available through B shares; and would have avoided the contingent deferred sales charges associated with B shares. The differences between A and B share mutual funds are explained more fully in an Investor Alert recently published by NASD: Investor Alert - Class B Mutual Fund Shares: Do They Make the Grade?

"In recommending mutual funds with different classes to investors, the broker must put his customer first. It is critical that a broker consider the costs of A shares versus B shares for the customer, and not the profit for the broker," said Mary L. Schapiro, NASD Vice Chairman and President of Regulatory Policy and Oversight. "NASD will continue to bring sales practice cases such as these when investors are sold mutual fund products that are unsuitable."

The cases announced today are:

- ♦ **Qimat R. Goyal, associated with Marsco Investment Corp., of Roseland, NJ,** was fined \$48,346 and suspended for nine months for unsuitable mutual fund B share recommendations to five customers. Goyal's suspension began August 18, 2003, and will conclude at the close of business May 17, 2004. (NASD Case #C9B030046)
- ♦ **Keith Korch, associated with Tucker Anthony, Inc.'s Sturbridge, MA office,** was fined \$60,000 and suspended for 30 days for recommending the purchase of \$3.5 million of mutual fund B shares to a customer. Given the dollar amount invested, the investor would have been able to purchase the A shares without any up-front sales charge. Korch's suspension began July 21, 2003, and concluded at the close of business August 19, 2003. (NASD Case #C11030022)

- ♦ **James Wheeler and James Wheeler & Co., Inc., of Denver, CO:** a fine of \$8,600 to be paid by the firm, a suspension of Wheeler for 10 business days and various remedial undertakings, including a requirement that before recommending B shares in the future the firm prepare and give to the customer an analysis of the relative costs of the two classes. The respondents recommended unsuitable purchases of B shares in 20 funds from 15 fund families to a customer who should have purchased A shares. Wheeler's suspension began August 18, 2003, and concluded at the close of business August 29, 2003. (NASD Case #C3A030033)
- ♦ **Robert Barmen, associated with UBS Financial Services, Inc.'s Pittsburgh, PA office,** was fined \$2,500 and suspended for 10 business days for unsuitable mutual fund B share recommendations to a customer. Barmen's suspension began September 2, 2003, and will conclude at the close of business September 15, 2003. (NASD Case #C9A030025)
- ♦ **Paul Pallo, a registered representative with Staten Securities of Staten Island, NY,** was charged in a complaint with selling mutual fund B shares to two customers when Class A shares would have been more suitable. (NASD Case #C9B030051)

Under NASD rules, an individual named in a complaint can file a response and request a hearing before an NASD disciplinary panel. Possible sanctions include a fine, order to pay restitution, censure, suspension, or bar from the securities industry.

## NASD Charges Louisiana Broker With Unsuitable Sales of Variable Annuities and Mutual Funds of More Than \$6 Million

NASD has charged John Steven Blount of Lake Charles, LA, with unsuitable sales of variable annuities and mutual funds to 11 customers totaling over \$6 million. These unsuitable sales generated almost \$220,000 in commissions. Blount's conduct involved a scheme to defraud investors and to frustrate attempts by his employer to supervise his activities. The transactions took place between 1998 and 2001, while Blount was a registered representative of NY Life Securities, Inc.

Blount's customers were older, conservative investors who were generally seeking current income from their investments. NASD's complaint charges that Blount's investment recommendations exposed his customers to excessive market risk, lacked sufficient liquidity, and failed to address the customers' needs for current income.

In one instance, the customer was a 62-year-old retiree who wished to keep his principal investment safe, and had told Blount that he anticipated the need within a few months for \$50,000 to buy a car and to make home repairs. Despite the customer's near-term need for liquidity, Blount recommended that the customer invest almost all of his liquid assets in a variable annuity contract that imposed surrender charges for early withdrawals during the first six years of the contract. Furthermore, Blount recommended allocating the investment to high-risk sub-accounts that were not consistent with the customer's desire to keep his principal safe. In order to buy a car and make home repairs, the customer was forced to draw on his home equity and subsequently had to take early withdrawals from his variable annuity to make the resulting loan payments.

The complaint also charges that Blount misrepresented material features of the variable annuities in order to induce customers to purchase the products. Additionally, in an effort to circumvent his firm's review of annuity and mutual fund transactions, Blount directed his sales assistant to falsify firm records regarding customers' financial situations and investment objectives.

"Our continuing examination focus on variable annuity sales and today's enforcement action should leave no doubt about our continuing serious concerns over how these products are sold," said Mary L. Schapiro, NASD Vice Chairman and President of Regulatory Policy and Oversight. "Brokers selling these complex products must be especially mindful of investors' risk tolerance and liquidity needs when recommending them as investments."

This case was brought in connection with an ongoing series of NASD special examinations and investigations that have focused on the sale of variable annuity products, and have resulted in over 75 annuity-related disciplinary actions taken by NASD since the beginning of 2001. As part of its overall focus on the sales of variable annuity contracts, NASD has issued educational alerts to both investors and firms to help ensure that these products are properly sold, which can be found at:

[www.nasdr.com/alert\\_exchange\\_lifeinsurance.htm](http://www.nasdr.com/alert_exchange_lifeinsurance.htm)

[www.nasdr.com/pdf-text/9935ntm.pdf](http://www.nasdr.com/pdf-text/9935ntm.pdf) and,

[www.nasdr.com/pdf-text/0044ntm.pdf](http://www.nasdr.com/pdf-text/0044ntm.pdf).

Under NASD rules, an individual named in a complaint can file a response and request a hearing before an NASD disciplinary panel. Possible sanctions include a fine, order to pay restitution, censure, suspension, or bar from the securities industry.