

AUGUST 2003

# Notices to Members

## Notices

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# Special Notice to Members

JULY 2003

## SUGGESTED ROUTING

Senior Management  
Legal and Compliance  
Operations Managers

## KEY TOPICS

NASD By-Laws  
Trading Activity Fee

INFORMATIONAL

## SEC Approves Increase to the Trading Activity Fee

### Executive Summary

On July 28, 2003, the Securities and Exchange Commission (SEC or Commission) approved an NASD rule filing amending the Trading Activity Fee (TAF) to establish a new rate for covered equity securities.<sup>1</sup> NASD had been collecting the TAF and determined that the equity rate needed to be increased to ensure adequate funding levels for its member regulatory program. The new TAF rates for covered equity securities will go into effect on September 1, 2003. A revised Trading Activity Fee Self-Reporting Form is available on the NASD Web Site at [http://www.nasdr.com/pdf-text/0275ntm\\_a.pdf](http://www.nasdr.com/pdf-text/0275ntm_a.pdf).

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

### Discussion

On May 30, 2003, the Commission approved the last component of a series of changes to NASD's member regulatory fee structure. Under the new fee structure, there are now three types of fees and assessments used to fund NASD's member regulatory activities: (1) the TAF;<sup>2</sup> (2) Personnel Assessment; and (3) Gross Income Assessment.<sup>3</sup> These fees, assessed upon and paid by member firms, are used by NASD to fund NASD's member regulatory activities, including the regulation of members through examinations, processing of membership applications, financial monitoring, policy, rulemaking, interpretive, and enforcement activities. The new member regulatory fee structure was designed to be revenue neutral to NASD and to better align NASD's regulatory fees with its functions, efforts, and costs.

03-43

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On June 11, 2003, NASD filed with the Commission a proposed rule change to adjust the TAF rate, and related maximum charge and minimum price exceptions, for equity securities. The proposed rule change was published for notice and comment in the Federal Register on June 25, 2003<sup>4</sup> and was subsequently approved by the Commission on July 28, 2003.<sup>5</sup>

NASD had been collecting the TAF for transactions effected after October 1, 2002 on a pilot basis, and determined that the equity rate needed to be increased to ensure adequate funding levels for its member regulatory program. The TAF will be increased from \$0.00005 per share to \$0.0001 per share for covered equity securities. The maximum charge for equity securities also was changed from \$5.00 per trade to \$10.00 per trade. Last, the exclusion for transactions in covered equity securities if the execution price is less than the TAF rate was modified from \$0.00005 to \$0.0001. The new TAF rates for covered equity securities will go into effect on September 1, 2003. Members should make the necessary changes to their internal systems to ensure compliance with the new TAF rates for covered equity securities by September 1, 2003. Additionally, a revised Trading Activity Fee Self-Reporting Form is available on the NASD Web Site at [http://www.nasdr.com/pdf-text/0275ntm\\_a.pdf](http://www.nasdr.com/pdf-text/0275ntm_a.pdf).

The proposed rate change is driven by lower than expected TAF revenues, not increased or unexpected member regulatory costs. NASD originally had proposed a rate of \$0.0001 per share for equity securities (announced on September 27, 2002 and published on NASD's Web Site), but after informal feedback from the membership about the level of volume meeting the definition of "covered equity security," NASD decided to reduce the rate to \$0.00005. Six months experience with the TAF has demonstrated that the initially proposed rate is more accurate to ensure revenue neutrality and adequate funding.

NASD periodically will analyze rates, volumes, and regulatory responsibilities to ensure adequate funding levels for its member regulatory programs.<sup>6</sup> NASD also will perform an analysis for the annual Personnel Assessment and Gross Income Assessment, to ensure adequate contributions from each component fee, as well as adequate levels of funding overall. In addition, NASD previously stated its intent to reduce the percentage that the TAF contributes to the overall funding structure in 2004 and again in 2005 (increasing the percentage funded by the PA and holding the GIA percentage static). NASD remains committed to that program, and should regulatory costs and market volumes remain constant, fee levels for the TAF for 2004 could be expected to drop by approximately 20%. Of course, NASD will analyze all relevant factors prior to making any determination to modify the TAF.

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## Endnotes

- 1 Securities Exchange Act Rel. No. 48234 (July 28, 2003) (File No. SR-NASD-2003-93).
- 2 Securities Exchange Act Rel. No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (File No. SR-NASD-2002-148).
- 3 Securities Exchange Act Rel. No. 47106 (Dec. 30, 2002), 68 FR 819 (January 7, 2003) (File No. SR-NASD-2002-99).
- 4 Securities Exchange Act Rel. No. 48061 (June 19, 2003), 68 FR 37877 (June 25, 2003) (File No. SR-NASD-2003-93).
- 5 Securities Exchange Act Rel. No. 48234 (July 28, 2003) (File No. SR-NASD-2003-93).
- 6 Specifically, NASD stated in the text of the TAF rule language that it will “periodically review these revenues in conjunction with these costs to determine the applicable rate.” NASD By-Laws, Schedule A, Section 1(a).

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# Notice to Members

AUGUST 2003

## SUGGESTED ROUTING

Executive Representative  
Legal & Compliance  
Senior Management  
Operations

## KEY TOPICS

Research Reports  
Qualification and Registration  
Continuing Education Requirements  
Advertising  
Investment Banking

## ACTION REQUIRED

### Research Analysts and Research Reports

SEC Approves Amendments to Rules Governing Research Analysts' Conflicts of Interest

#### Executive Summary

On July 29, 2003, the Securities and Exchange Commission (SEC) approved new NASD Rule 1050 (Registration of Research Analysts) and amendments to Rule 1120 (Continuing Education Requirements) and Rule 2711 (Research Analysts and Research Reports).<sup>1</sup> Generally, the new rule and amendments impose registration, qualification, and continuing education requirements on research analysts; further separate analyst compensation from investment banking influence; prohibit analysts from issuing "booster shot" research reports; prohibit analysts from soliciting investment banking business; and require members to publish a final research report when they terminate coverage of a subject company. The amendments also revise Rule 2711 to augment disclosure requirements and make other changes necessary to comply with the research analyst provisions of the Sarbanes-Oxley Act of 2002.

The SEC also approved on the same day similar amendments to New York Stock Exchange Rules 344, 345A, 351 and 472. NASD generally will implement the new rule and amendments in phases during the period from July 29, 2003, to January 26, 2004. The implementation schedule is set forth below.

This *Notice* includes as Attachment A the text of the new rule and amendments.

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## Questions/Further Information

Questions concerning this *Notice* may be directed to Nileema Pargaonker in NASD's Corporate Financing Department, Regulatory Policy and Oversight, at (240) 386-4623, or Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

## Implementation Schedule

New Rule 1050 and the amendments to Rules 1120 and 2711 will take effect as follows:

- ▶ Qualification, examination, registration, and continuing education requirements for research analysts (new Rule 1050 and amendments to Rule 1120): January 26, 2004, or such later date as determined by NASD.
- ▶ New compensation and client disclosure provisions (Rule 2711(h)(2)): January 26, 2004, plus up to an additional 90 days as deemed appropriate by NASD on a case-by-case basis.
- ▶ Rule 2711(h)(2)(C) – Exemption from Disclosure Requirements:
  - ▶ As applied to disclosures under Rules 2711(h)(2)(A)(ii)(b) and (c): July 29, 2003.
  - ▶ As applied to disclosures under Rule 2711(h)(2)(A)(iii)(b), (h)(2)(B)(i) and (iii): January 26, 2004.
- ▶ Research analyst compensation review procedures (Rule 2711(d)(2)): October 27, 2003.
- ▶ Prohibition of retaliation against research analysts (Rule 2711(j)): July 29, 2003.
- ▶ Exceptions for small firms (Rule 2711(k)): July 29, 2003.
- ▶ All other rule changes: September 29, 2003.

## Endnote

- 1 SEC Release No. 34-48252 (July 29, 2003), 68 Fed. Reg. 45875 (Aug. 4, 2003).

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## ATTACHMENT A

This attachment provides the text of new Rule 1050 and the amendments to Rules 1120 and 2711. New text is underlined, and deleted text is bracketed. Paragraphs that have not been revised are designated as "No change."

### Rule 1050. Registration of Research Analysts

All persons associated with a member who are to function as research analysts shall be registered with NASD. Before their registrations can become effective, they shall pass a Qualification Examination for Research Analysts as specified by the Board of Governors. For the purposes of this Rule 1050, "research analyst" shall mean an associated person who is primarily responsible for the preparation of the substance of a research report or whose name appears on a research report.

\* \* \* \* \*

### Rule 1120. Continuing Education Requirements

This Rule prescribes requirements regarding the continuing education of certain registered persons subsequent to their initial qualification and registration with the Association. The requirements shall consist of a Regulatory Element and a Firm Element as set forth below.

#### (a) Regulatory Element

(1) through (4) No change.

#### (5) Definition of Registered Person

For purposes of this Rule, the term "registered person" means any person registered with [the Association]NASD as a representative, principal, [or] assistant representative or research analyst pursuant to Rule 1020, 1030, 1040, 1050 and 1110 Series.

(6) No change.

#### (b) Firm Element

##### (1) Persons Subject to the Firm Element

The requirements of this subparagraph shall apply to any person registered with the member who has direct contact with customers in the conduct of the member's securities sales, trading and investment banking activities, any person registered as a research analyst pursuant to Rule 1050, and to the immediate supervisors of such persons, (collectively, "covered registered persons"). "Customer" shall mean any natural person and any

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organization, other than another broker or dealer, executing securities transactions with or through or receiving investment banking services from a member.

**(2) Standards for the Firm Element**

(A) No change.

(B) Minimum Standards for Training Programs – Programs used to implement a member’s training plan must be appropriate for the business of the member and, at a minimum must cover the following matters concerning securities products, services, and strategies offered by the member:

(i) General investment features and associated risk factors;

(ii) Suitability and sales practice considerations; [and]

(iii) Applicable regulatory requirements[.]; and

(iv) With respect to registered research analysts and their immediate supervisors, training in ethics, professional responsibility and the requirements of Rule 2711.

(C) No change.

(3) through (4) No change.

\* \* \* \* \*

**Rule 2711. Research Analysts and Research Reports**

**(a) Definitions**

For purposes of this rule, the following terms shall be defined as provided.

(1) through (3) No change.

(4) “Public appearance” means any participation in a seminar, forum (including an interactive electronic forum), radio, [or] television or print media interview, or other public speaking activity, or the writing of a print media article, in which a research analyst makes a recommendation or offers an opinion concerning an equity security.

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(5) "Research analyst" means the associated person who is [principally] primarily responsible for, and any associated person who reports directly or indirectly to such a research analyst in connection with, preparation of the substance of a research report, whether or not any such person has the job title of "research analyst."

(6) "Research analyst account" means any account in which a research analyst or member of the research analyst's household has a financial interest, or over which such analyst has discretion or control, other than an investment company registered under the Investment Company Act of 1940. This term does not include a "blind trust" account that is controlled by a person other than the research analyst or member of the research analyst's household where neither the research analyst nor a member of the research analyst's household knows of the account's investments or investment transactions.

(7) No change.

(8) "Research report" means a written or electronic communication [which]~~that~~ includes an analysis of equity securities or individual companies or industries, and [which]~~that~~ provides information reasonably sufficient upon which to base an investment decision [and includes a recommendation].

(9) "Subject company" means the company whose equity securities are the subject of a research report or [recommendation in] a public appearance.

**(b) Restrictions on [Investment Banking Department]Relationships with Research Department**

(1) No research analyst may be subject to the supervision or control of any employee of the member's investment banking department, and no personnel engaged in investment banking activities may have any influence or control over the compensatory evaluation of a research analyst.

(2) Except as provided in paragraph (b)(3), no employee of the investment banking department or any other employee of the member who is not directly responsible for investment research ("non-research personnel"), other than legal or compliance personnel, may review or approve a research report of the member before its publication.

(3) [Investment banking]Non-research personnel may review a research report before its publication as necessary only to verify the factual accuracy of information in the research report or [to review the research report for]identify any potential conflict of interest, provided that:

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(A) any written communication between [investment banking]non-research personnel and research department personnel concerning [such]the content of a research report must be made either through [an] authorized legal or compliance [official]personnel of the member or in a transmission copied to such [an official]personnel; and

(B) any oral communication between [investment banking]non-research personnel and research department personnel concerning [such]the content of a research report must be documented and made either through [an] authorized legal or compliance [official]personnel acting as intermediary or in a conversation conducted in the presence of such [an official]personnel.

**(c) Restrictions on [Review of a Research Report by]Communications with the Subject Company**

(1) No change.

(2) A member may submit sections of such a research report to the subject company before its publication for review as necessary only to verify the factual accuracy of information in those sections, provided that:

(A) No change.

(B) a complete draft of the research report is provided to [the] legal or compliance [department]personnel before sections of the report are submitted to the subject company; and

(C) if after submitting the sections of the research report to the subject company the research department intends to change the proposed rating or price target, it must first provide written justification to, and receive written authorization from, [the] legal or compliance [department]personnel for the change. The member must retain copies of any draft and the final version of such a research report for three years following its publication.

(3) No change.

(4) No research analyst may participate in efforts to solicit investment banking business. Accordingly, no research analyst may, among other things, participate in any "pitches" for investment banking business to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business.

**(d) [Prohibition of Certain Forms of]Restrictions on Research Analyst Compensation**

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(1) No member may pay any bonus, salary or other form of compensation to a research analyst that is based upon a specific investment banking services transaction.

(2) The compensation of a research analyst who is primarily responsible for the preparation of the substance of a research report must be reviewed and approved at least annually by a committee that reports to the member's board of directors, or when the member has no board of directors, to a senior executive officer of the member. This committee may not have representation from the member's investment banking department. The committee must consider the following factors when reviewing such a research analyst's compensation, if applicable:

(A) the research analyst's individual performance, including the analyst's productivity and the quality of the analyst's research;

(B) the correlation between the research analyst's recommendations and the stock price performance; and

(C) the overall ratings received from clients, sales force, and peers independent of the member's investment banking department, and other independent ratings services.

The committee may not consider as a factor in reviewing and approving such a research analyst's compensation his or her contributions to the member's investment banking business. The committee must document the basis upon which each such research analyst's compensation was established. The annual attestation required by Rule 2711(i) must certify that the committee reviewed and approved each such research analyst's compensation and documented the basis upon which this compensation was established.

(e) No change.

**(f) [Imposition of Quiet Periods]Restrictions on Publishing Research Reports and Public Appearances; Termination of Coverage**

(1) No member may publish or otherwise distribute a research report and no research analyst may make a public appearance regarding a subject company for which the member acted as manager or co-manager of:

[(1)](A) an initial public offering, for 40 calendar days following the date of the offering; or

[(2)](B) a secondary offering, for 10 calendar days following the date of the offering; provided that:

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[(A)](i) paragraphs (f)(1)(A) and (f)(2)(1)(B) will not prevent a member from publishing or otherwise distributing a research report, or prevent a research analyst from making a public appearance, concerning the effects of significant news or a significant event on the subject company within such 40- and 10-day periods, and provided further that [the] legal [and]or compliance [department]personnel authorize[s] publication of that research report before it is issued or authorize the public appearance before it is made; and

[(B)](ii) paragraph (f)(2)(1)(B) will not prevent a member from publishing or otherwise distributing a research report pursuant to SEC Rule 139 regarding a subject company with “actively-traded securities,” as defined in Regulation M, 17 CFR 242.101(c)(1), and will not prevent a research analyst from making a public appearance concerning such a company.

(2) No member that has agreed to participate or is participating as an underwriter or dealer (other than as manager or co-manager) of an issuer’s initial public offering may publish or otherwise distribute a research report or make a public appearance regarding that issuer for 25 calendar days after the date of the offering.

(3) For purposes of paragraphs (f)(1) and (f)(2), the term “date of the offering” refers to the later of the effective date of the registration statement or the first date on which the security was bona fide offered to the public.

(4) No member that has acted as a manager or co-manager of a securities offering may publish or otherwise distribute a research report or make a public appearance concerning a subject company 15 days prior to and after the expiration, waiver or termination of a lock-up agreement or any other agreement that the member has entered into with a subject company or its shareholders that restricts or prohibits the sale of securities held by the subject company or its shareholders after the completion of a securities offering. This paragraph will not prevent a member from publishing or otherwise distributing a research report concerning the effects of significant news or a significant event on the subject company within such period, provided legal or compliance personnel authorize publication of that research report before it is issued. In addition, this paragraph shall not apply to the publication or distribution of a research report pursuant to SEC Rule 139 regarding a subject company with “actively traded securities,” as defined in Regulation M, 17 CFR 242.101(c)(1), or to a public appearance concerning such a subject company.

(5) If a member intends to terminate its research coverage of a subject company, notice of this termination must be made. The member must make available a final research report on the subject company using the means of dissemination equivalent to those it ordinarily uses to provide the customer with its research reports on the subject company. The report must be comparable in scope and detail to prior research reports and must include a final recommendation or rating, unless it is

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impracticable for the member to produce a comparable report (e.g., if the research analyst covering the subject company or sector has left the member or if the member terminates coverage of the industry or sector). If it is impracticable to produce a final recommendation or rating, the final research report must disclose the member's rationale for the decision to terminate coverage.

**(g) Restrictions on Personal Trading by Research Analysts**

(1) No change.

(2) No research analyst account may purchase or sell any security issued by a company that the research analyst follows, or any option on or derivative of such security, for a period beginning 30 calendar days before and ending five calendar days after the publication of a research report concerning the company or a change in a rating or price target of the company's securities; provided that:

(A) No change.

(B) a member may permit a research analyst account to purchase or sell any security issued by a subject company within 30 calendar days before the publication of a research report or change in the rating or price target of the subject company's securities due to significant news or a significant event concerning the subject company, provided that [the member's] legal or compliance [department] personnel pre-approve[s] the research report and any change in the rating or price target.

(3) No change.

(4) [A member's ] Legal or compliance [department] personnel may authorize a transaction otherwise prohibited by paragraphs (g)(2) and (g)(3) based upon an unanticipated significant change in the personal financial circumstances of the beneficial owner of the research analyst account, provided that:

(A) [the] legal or compliance [department] personnel authorize[s] the transaction before it is entered;

(B) each exception is granted in compliance with policies and procedures adopted by the member that are reasonably designed to ensure that these transactions do not create a conflict of interest between the professional responsibilities of the research analyst and the personal trading activities of a research analyst account; and

(C) No change.

(5) No change.

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(6) Legal or compliance personnel of the member shall pre-approve all transactions of persons who oversee research analysts to the extent such transactions involve equity securities of subject companies covered by the research analysts that they oversee. This pre-approval requirement shall apply to all persons, such as the director of research, supervisory analyst, or member of a committee, who have direct influence or control with respect to the preparation of the substance of research reports or establishing or changing a rating or price target of a subject company's equity securities.

**(h) Disclosure Requirements**

(1) No change.

**(2) Receipt of Compensation**

(A) A member must disclose in research reports [if]:

(i) if the research analyst [principally responsible for the preparation of the report] received any compensation:

a. [that is] based upon (among other factors) the member's investment banking services revenues; [and ]or

b. from the subject company in the past 12 months.

(ii) if the member or any [its ]affiliate[s]:

a. managed or co-managed a public offering of securities for the subject company in the past 12 months;

b. received compensation for investment banking services from the subject company in the past 12 months; or

c. expects to receive or intends to seek compensation for investment banking services from the subject company in the next 3 months.

(iii) if (1) as of the end of the month immediately preceding the date of publication of the research report (or the end of the second most recent month if the publication date is less than 30 calendar days after the end of the most recent month) or (2) to the extent the research analyst or an employee of the member with the ability to influence the substance of the research knows:

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a. the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months; or

b. the subject company currently is, or during the 12-month period preceding the date of distribution of the research report was, a client of the member. In such cases, the member also must disclose the types of services provided to the subject company. For purposes of this Rule 2711(h)(2), the types of services provided to the subject company shall be described as investment banking services, non-investment banking securities-related services, and non-securities services.

(iv) if, to the extent the research analyst or an employee of the member with the ability to influence the substance of the research report knows an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

(v) if, to the extent the research analyst or member has reason to know, an affiliate of the member received any compensation for products or services other than investment banking services from the subject company in the past 12 months.

a. This requirement will be deemed satisfied if such compensation is disclosed in research reports within 30 days after completion of the last calendar quarter, provided that the member has taken steps reasonably designed to identify any such compensation during that calendar quarter. This requirement shall not apply to any subject company as to which the member initiated coverage since the beginning of the current calendar quarter.

b. The research analyst and the member will be presumed not to have reason to know whether an affiliate received any compensation for products or services other than investment banking services from the subject company in the past 12 months if the member maintains and enforces policies and procedures reasonably designed to prevent the research analysts and employees of the member with the ability to influence the substance of research reports from, directly or indirectly, receiving information from the affiliate concerning whether the affiliate received such compensation.

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(vi) For the purposes of this Rule 2711(h)(2), an employee of the member with the ability to influence the substance of the research report is an employee who, in the ordinary course of that person's duties, has the authority to review the particular research report and to change that research report prior to publication.

(B) A research analyst must disclose in public appearances:

(i) if, to the extent the research analyst knows or has reason to know, the member or any affiliate received any compensation from the subject company in the past 12 months;

(ii) if the research analyst received any compensation from the subject company in the past 12 months; or

(iii) if, to the extent the research analyst knows or has reason to know, [that ]the subject company currently is, or during the 12-month period preceding the date of distribution of the research report, was, a client of the member [or its affiliates]. In such cases, the research analyst also must disclose the types of services provided to the subject company, if known by the research analyst.

(C) A member or research analyst will not be required to make a disclosure required by paragraphs (h)(2)(A)(ii)(b) and (c), (h)(2)(A)(iii)(b), or (h)(2)(B)(i) and (iii) to the extent such disclosure would reveal material non-public information regarding specific potential future investment banking transactions of the subject company.

(3) through (11) No change.

## **(12) Records of Public Appearances**

Members must maintain records of public appearances by research analysts sufficient to demonstrate compliance by those research analysts with the applicable disclosure requirements under paragraph (h) of this Rule. Such records must be maintained for three years from the date of the public appearance.

### **(i) Supervisory Procedures**

Each member subject to this rule must adopt and implement written supervisory procedures reasonably designed to ensure that the member and its employees comply with the provisions of this rule (including the attestation requirements of Rule 2711(d)(2)), and a senior officer of such a member must attest annually to [the Association]NASD by April 1 of each year that it has adopted and implemented those procedures.

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**(j) Prohibition of Retaliation Against Research Analysts**

No member and no employee of a member who is involved with the member's investment banking activities may, directly or indirectly, retaliate against or threaten to retaliate against any research analyst employed by the member or its affiliates as a result of an adverse, negative, or otherwise unfavorable research report or public appearance written or made by the research analyst that may adversely affect the member's present or prospective investment banking relationship with the subject company of a research report. This prohibition shall not limit a member's authority to discipline or terminate a research analyst, in accordance with the member's policies and procedures, for any cause other than the writing of such an unfavorable research report or the making of such an unfavorable public appearance.

**(k) Exceptions for Small Firms**

The provisions of paragraph (b) shall not apply to members that over the previous three years, on average per year, have participated in 10 or fewer investment banking services transactions as manager or co-manager and generated \$5 million or less in gross investment banking services revenues from those transactions. For purposes of this paragraph (k), the term "investment banking services transactions" includes the underwriting of both corporate debt and equity securities but not municipal securities. Members that qualify for this exemption must maintain records for three years of any communication that, but for this exemption, would be subject to paragraph (b) of this Rule.

# Notice to Members

AUGUST 2003

## SUGGESTED ROUTING

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

## KEY TOPICS

Underwriting  
Debt Securities  
Operations  
Rule 6200 Series  
Transaction Reporting

INFORMATIONAL

## Corporate Debt Securities

SEC Approves Amendments to TRACE Rule 6260 to Require New Issue Notifications to Include Dissemination Eligibility Information and Be Submitted in Writing

### Executive Summary

On August 8, 2003, the Securities and Exchange Commission (SEC or Commission) approved amendments to Rule 6260 of the Trade Reporting and Compliance Engine (TRACE) Rules, the Rule 6200 Series.<sup>1</sup> The amendments to Rule 6260 require that a managing underwriter, or, if there is no managing underwriter, the group of underwriters, of an initial offering of a TRACE-eligible security provide information that will aid NASD in determining if the new issue will be subject to dissemination when the managing underwriter or other underwriter submits the notification of the new issue to NASD (new issue notification). The specific additional information required will vary according to the dissemination requirements in Rule 6250. The amendments also require that the new issue notification be submitted in writing. Rule 6260, as amended, is set forth in Attachment A.

The amendments to Rule 6260 will become effective on August 25, 2003.

### Questions/Further Information

Questions concerning this *Notice* should 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.

03-45

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## Background and Discussion

Currently, Rule 6260(b) requires a member that is the managing underwriter, or if there is no managing underwriter, the group of underwriters (hereinafter, “managing underwriter” refers to any underwriter responsible for complying with Rule 6260), of any newly issued TRACE-eligible security to submit a new issue notification to NASD. The new issue notification must contain basic descriptive information about the new TRACE-eligible security. Specifically, the Rule requires that the new issue notification contain: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; and (6) a brief description of the issue.

Rule 6260(b), as amended, requires a managing underwriter to provide to the TRACE Operations Center additional information, as determined by NASD staff, that is required to determine if the new TRACE-eligible security is subject to dissemination under Rule 6250, in addition to the six items of information specified above. The purpose of the new requirement is to provide NASD staff relevant information that will allow NASD staff to quickly and accurately determine if a newly issued TRACE-eligible security is subject to dissemination. The amendments are necessary because NASD, with the support of industry members, has developed a variety of criteria, which must be reviewed, in order to determine if a new TRACE-eligible security is subject to dissemination.

The dissemination criteria for TRACE-eligible securities are set forth in Rule 6250(a)(1) through (a)(4). For example, in paragraph (a)(1), securities that are Investment Grade<sup>2</sup> at the time of receipt of the transaction report and have an initial issuance size of \$1 billion or greater are subject to dissemination. Also, in paragraph (a)(3), securities that are Investment Grade and rated by Moody’s Investors Service, Inc.<sup>3</sup> as “A3” or higher and by Standard & Poor’s, a division of McGraw Hill Co., Inc.,<sup>4</sup> as “A-” or higher and have an original issuance size of \$100 million or greater are subject to dissemination. Accordingly, in many but not all cases, the additional information that NASD staff will require to determine if the newly issued security is subject to dissemination will be the rating(s) of the security and the original issue size of the offering. If, in a particular instance, NASD staff determines that other additional information is needed to quickly and accurately determine if the new TRACE-eligible security is subject to dissemination, NASD staff will require the managing underwriter to provide such information.

In the future, Rule 6250 may be amended to add additional factors that must be considered by staff in order to determine if a newly issued TRACE-eligible security is required to be disseminated. If Rule 6250 were so amended, under Rule 6260(b), NASD staff would require managing underwriters to provide any additional type of information relating to those factors that would be needed by NASD staff in order to quickly and accurately determine if newly issued TRACE-eligible securities are subject to dissemination. NASD would inform all members of the changes in the new issue notification information requirements in a *Notice to Members* and through other media.

Members are reminded that any additional information required must be provided within the time frames set forth in Rule 6260(b).

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## Provide Written New Issue Notification

Rule 6260, as amended, requires the member that is submitting the new issue notification to provide the information in writing. The written notification may be in the form of an e-mail or facsimile transmission.

## Effective Date

The amendments to Rule 6260 will become effective on August 25, 2003.

## Endnotes

- 1 See Securities Exchange Act Release No. 48305 (August 8, 2003), 68 F.R. 48656 (August 14, 2003) (File No. SR-NASD-2003-99).
- 2 The term "Investment Grade" is defined in Rule 6210(h).
- 3 Moody's Investors Service, Inc. (Moody's), is a nationally recognized statistical rating organization. Moody's is a registered trademark of Moody's Investors Service. Moody's ratings are proprietary to Moody's and are protected by copyright and other intellectual property laws. Moody's licenses ratings to NASD. Ratings may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without Moody's prior written consent.
- 4 Standard & Poor's, a division of the McGraw-Hill Companies, Inc. (S&P), is a nationally recognized statistical rating organization. S&P's ratings are proprietary to S&P and are protected by copyright and other intellectual property laws. S&P's licenses ratings to NASD. Ratings may not be copied or otherwise reproduced, repackaged, further transmitted, transferred, disseminated, redistributed or resold, or stored for subsequent use for any such purpose, in whole or in part, in any form or manner or by any means whatsoever, by any person without S&P's prior written consent.

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## ATTACHMENT A

New text is underlined, and deleted text is bracketed.

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

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

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

(b) For such TRACE-eligible securities, the managing underwriter must provide to the TRACE Operations Center, by email or facsimile: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; [and ](6) a brief description of the issue (e.g., senior subordinated note, senior note)[,]; and, (7) information, as determined by NASD, that is required to determine if a TRACE-eligible security must be disseminated under Rule 6250 (e.g., size of issue and rating), or if any of items (2) through (7)[(6)] has not been determined, such other information as NASD deems necessary. The managing underwriter must obtain the CUSIP number and provide it and the information listed as (2) through (7)[(6)] not later than 5:00 p.m. on the business day preceding the day that the registration statement becomes effective, or, if registration is not required, the day before the securities will be priced. If an issuer notifies a managing underwriter, or the issuer and the managing underwriter determine, that the TRACE-eligible securities of the issuer shall be priced, offered and sold the same business day in an intra-day offering under Rule 415 of the Securities Act of 1933 or Rule 144A of the Securities Act of 1933, the managing underwriter shall provide the information not later than 5:00 p.m. on the day that the securities are priced and offered, provided that if such securities are priced and offered on or after 5:00 p.m., the managing underwriter shall provide the information not later than 5:00 p.m. on the next business day. The managing underwriter must make a good faith determination that the security is a TRACE-eligible security before submitting the information to the TRACE Operations Center.

# Notice to Members

AUGUST 2003

## SUGGESTED ROUTING

Legal and Compliance  
Operations  
Technology  
Trading and Market Making

## KEY TOPICS

Underwriting Activity Reports  
Public Offerings

INFORMATIONAL

## Underwriting Activity Reports

### Amendments Relating to Requests for Underwriting Activity Reports

### Executive Summary

NASD has amended its rules to require members to request Underwriting Activity Reports (UARs) from NASD's Market Regulation Department rather than NASD's Corporate Finance Department. The rule change, as amended, was filed with the Securities and Exchange Commission (SEC) on July 9, 2003. Pursuant to Section 19(b)(3)(A)(iii) of the Securities Exchange Act of 1934 and SEC Rule 19b-4(f)(3) thereunder, the rule change became effective upon filing.<sup>1</sup>

### Questions/Further Information

Questions regarding this *Notice* may be directed to Patrick Geraghty, Associate Director, Quality of Markets, NASD Market Regulation Department, (240) 386-4973.

### Background

NASD Rules 2710(b)(10) and 6540(d) require, among other things, that a member acting as the lead manager of a distribution of a publicly traded security that is subject to SEC Rule 101 of Regulation M submit a request to NASD for a UAR. A member must request a UAR at the time a registration statement or similar offering document is filed with NASD's Corporate Finance Department, the SEC, or other regulatory agency, or, if not filed with any regulatory agency, at least two business days prior to the commencement of the restricted period under SEC Rule 101.

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Since June 2002, NASD staff has asked that members submit their requests for UARs to NASD's Market Regulation Department rather than NASD's Corporate Finance Department, as was previously required under NASD rules. NASD staff believes that the Market Regulation Department is better-suited to handle such requests because the analysts within the Market Regulation Department are trained specifically to review UARs for accuracy and are better-equipped to answer questions relating to the information provided in UARs. Accordingly, NASD has amended its rules to require that members submit a request for a UAR to the Market Regulation Department instead of the Corporate Finance Department. The rule change does not affect the substantive content of UAR requests, the manner in which a request can be submitted, or the time period associated with a request.

## Endnotes

- 1 File No. SR-NASD-2003-75. See Exchange Act Release No. 48215 (July 23, 2003), 68 Fed. Reg. 44826 (July 30, 2003) (Notice of Filing and Immediate Effectiveness of Rule Change).

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# Notice to Members

AUGUST 2003

## SUGGESTED ROUTING

Legal & Compliance  
Senior Management  
Accounting  
Operations  
Retail

## KEY TOPICS

Mutual Funds  
Mutual Fund Breakpoints  
Customer Refunds  
Net Capital Compliance

IMMEDIATE ACTION REQUIRED

## Refunds to Customers Who Did Not Receive Appropriate Breakpoint Discounts in Connection with the Purchase of Class A Shares of Front-End Load Mutual Funds and the Capital Treatment of Refund Liability

### Background

In late 2002, as a result of several routine examinations, NASD discovered that some members had failed to deliver breakpoint discounts to investors purchasing Class A shares of front-end load mutual funds. This led to a joint examination of 43 broker/dealers by NASD, the Securities and Exchange Commission ("SEC"), and the New York Stock Exchange ("NYSE"), which confirmed that broker/dealers were not uniformly delivering appropriate breakpoint discounts. In December 2002, NASD issued *Special Notice to Members 02-85*, which reminded members of their obligation to deliver all available breakpoint discounts to customers purchasing Class A shares of front-end load mutual funds.

In March 2003, NASD directed member firms that processed 100 or more automated purchases of front-end load mutual funds in either 2001 or 2002 to conduct a "self-assessment" of their record of delivering breakpoint discounts to customers. The self-assessment was designed to produce a statistically significant sample that would allow NASD to determine the scope of overcharges at individual member firms and to gauge the scope of the problem across the industry as a whole.

A preliminary analysis of the data obtained as a result of the self-assessment indicates that most members did not uniformly deliver appropriate breakpoint discounts; the degree to which firms applied the appropriate discount varied. It is imperative that

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member firms make appropriate refunds to customers who did not receive discounts for which they were eligible and that members properly account for overcharge liabilities. This *Notice to Members* provides guidelines for firms to follow when calculating refunds to customers and discusses how firms must account for their anticipated refund liabilities.<sup>1</sup>

## Questions/Further Information

Questions regarding refunds may be directed to Janene Marasciullo, Senior Attorney, NASD Office of General Counsel, at (202) 974-2978. Questions regarding net capital issues may be directed to Susan DeMando, Director, Financial Operations, NASD, Member Regulation at (202) 728-8411.

## Discussion

### Refunds to Customers

NASD expects that members will make refunds to customers expeditiously where they are aware that customers did not receive the sales load discount to which they were entitled. A number of NASD member firms have already begun that process.<sup>2</sup> Members who have completed the self-assessment have already identified certain customers who did not receive available breakpoint discounts. Members should take immediate steps to make refunds to these customers in accordance with the calculation guidelines set forth below.

Additionally, NASD expects members to make refunds to any customers who come forward and assert that they did not receive all applicable breakpoint discounts. Once a member is in contact with a customer seeking a refund, the member firm must review its records to determine whether the customer is entitled to a refund and to determine the amount of the appropriate refund.<sup>3</sup> A member may not place the burden of demonstrating entitlement to a refund upon the customer and, therefore, may not refuse to make a refund to a customer without first checking its own records to determine whether the customer is entitled to a refund. However, members may require documentation from customers where the availability of the breakpoint discount can only be determined by reference to records not held by the member.

NASD has taken steps to inform investors regarding the availability of breakpoint discounts and the problems that the financial industry experienced delivering breakpoint discounts in the past.<sup>4</sup> NASD has also advised investors that they may be entitled to refunds if they did not receive appropriate breakpoint discounts on past mutual fund purchases.<sup>5</sup> Therefore, NASD members should be prepared to make prompt refunds to those customers who were identified during the self-assessment as having been overcharged, as well as other customers who come forward seeking refunds on their own and are owed a refund based on the firm's assessment and in accordance with the guidelines set forth below.

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## Refund Calculation Guidelines

Members should make full refunds to customers who have valid claims that they were overcharged. To ensure that the refunds make customers whole and are distributed in a timely and equitable fashion, NASD has developed the following guidelines that firms must follow when providing refunds:

- ▶ Refunds should be made in cash sent to the customer, or through cash deposits made to an existing customer's account with notice to that customer.
- ▶ Refunds should be equal to the amount of the sales load overcharge plus interest at a simple rate of at least 2.5%, for overcharges that occurred between January 1, 2001, and the present. For transactions that took place prior to that time, members should use a comparable interest rate.<sup>6</sup>
- ▶ Refunds should be made regardless of the performance of the mutual fund purchased by the customer.

## Making and Maintenance of Records

Members are reminded that, pursuant to NASD Rule 3110 and Exchange Act Rules 17a-3 and 17a-4, they must make and preserve records that reflect their determinations regarding customers' refund eligibility and the calculation and payment of any such refunds. Members should ensure that they maintain these records for the first two years in an easily accessible place.

## Capital Treatment of Refund Liability

A member's obligation to provide refunds to customers who were overcharged may impact net capital. NASD provides the following guidance to member firms regarding the accounting treatment applicable to a member's obligation to provide refunds to customers who did not receive breakpoint discounts to which they were entitled. NASD has concluded that a member's refund obligation comes within the definition of "liability" set forth in the Financial Accounting Standards Board's Statement of Financial Accounting Concept No. 6 ("SFAC No. 6") because it meets each of the following characteristics:

- (a) It is a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand;
- (b) The duty or responsibility obligates a particular entity, leaving it no discretion to avoid the future sacrifice;<sup>7</sup> and
- (c) The transaction or other event obligating the entity has already happened.

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The recognition of this liability may impact a member's net capital computation, and compliance with net capital requirements set by SEC Rule 15c3-1, and other financial reporting.

In determining the amount of this liability, members should consider that SFAC No. 6 specifically recognizes that the amount of a liability does not need to be certain before it is recorded. SFAC No. 6 ¶ 46.<sup>8</sup> Accordingly, approximations and estimates may be used to record a liability. Id. Thus, firms must determine their probable liability based upon currently available information in accordance with SFAC No. 6 and generally accepted accounting principles ("GAAP").<sup>9</sup>

### Segregation and Protection of Funds Necessary to Satisfy Refund Liability to Investors

Regardless of the methodology that a firm uses to determine the amount of its liability, each member must, to the extent necessary, segregate the funds needed to satisfy its liability through either a Special Reserve Bank Account for the Exclusive Benefit of Customers ("Special Reserve Bank Account") or through an account established for the benefit of customers in accordance with section (k)(2)(i) of Exchange Act Rule 15c-3-3 ("A Special Account"). To ensure that firms properly segregate the funds set aside to satisfy their refund liability, NASD provides the following guidelines for setting aside and protecting the funds necessary to satisfy a member's refund obligation:

- ▶ Member firms that are fully subject to the Customer Protection Rule (SEC Rule 15c3-3), must, beginning with their next and on all subsequent Reserve Requirement computation dates (whether weekly or monthly):
  - ▶ Include the refund liability amount as a credit in the Reserve Formula; and
  - ▶ Pay investor refunds as soon as feasible, while continuing to include the refund liability amount as a credit in the Reserve Formula.
- ▶ Member firms that are exempt from the Reserve Requirement computation of the Customer Protection Rule must pay the amounts owed to any investor making a claim within two business days of determining the proper amount of the claim. To the extent that such member firms do not pay all claims within two business days of determining the proper amount of the claim, these member firms must:
  - ▶ Immediately establish a *separate* Special Account for the benefit of customers in accordance with the requirements of paragraph (k)(2)(i) of SEC Rule 15c3-3;
  - ▶ Deposit the remaining amount of the liability into that Special Account; and,
  - ▶ Pay the investor refunds as soon as feasible from and through the separate Special Account, while continuing to hold any unpaid refund liability in that account.

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## Conclusion

Firms must take prompt and immediate action to provide refunds to customers in accordance with the guidelines set forth above. Failure to provide such refunds will subject firms to disciplinary action, separate and apart from any disciplinary actions that may result from the initial failure to deliver breakpoint discounts. Furthermore, firms must treat their refund obligations as liabilities on their financial statements and must ensure that they are operating in net capital compliance after accounting for these liabilities. Finally, firms must take appropriate actions to segregate and protect the funds necessary to satisfy their refund liability.

## Endnotes

- 1 NASD, in coordination with SEC staff, is determining the nature and scope of further regulatory action against certain firms based upon their record of delivering breakpoint discounts.
- 2 Any firm that has already provided its customers with refunds should contact NASD if it used an alternative methodology to determine whether it calculated its refunds in a satisfactory manner.
- 3 Firms that do not respond appropriately to customer requests for refunds may be subject to disciplinary action by NASD.
- 4 NASD Investor Alert, "Mutual Fund Breakpoints: A Break Worth Taking," available at [www.nasd.com/investor/alerts/alert\\_breakpoint.htm](http://www.nasd.com/investor/alerts/alert_breakpoint.htm); Report of Joint NASD/Industry Task Force on Breakpoints, available at [www.nasdr.com/breakpoints\\_report.asp](http://www.nasdr.com/breakpoints_report.asp).
- 5 NASD has already stated that investors have a right to receive a refund to compensate them for sales load overcharges. See July 22, 2003, NASD Press Release, "Joint NASD/Industry Breakpoint Task Force Issues Report," in which NASD Chairman Robert Glauber stated, "NASD is committed to helping investors receive refunds for missed breakpoints." See also February 18, 2003, NASD Press Release, "NASD Announces Joint NASD/Industry Breakpoint Task Force." NASD recognizes that some refund claims may prove to be without merit or be time-barred. However, NASD expects members who receive claims for refunds to carefully review the merits of each claim and provide refunds in all cases where there is a timely and meritorious claim for a refund.
- 6 The 2.5% rate is based on data posted on the Federal Reserve Web Site for simple average dealer rates on negotiated six month CDs nationally traded in the secondary market from January 2001 until June 2003. See <http://www.federalreserve.gov/releases/h15/data/m/cd6m.txt>. Data posted on the Federal Reserve Site for six month CDs for periods prior to January 2, 2001, may be considered for determining refunds relating to overcharges outside of the period covered by the self-assessment.
- 7 Members are obligated to provide all breakpoint discounts disclosed in a mutual fund's prospectus. However, the Financial Accounting Standards Board has recognized that "although most liabilities rest generally on a foundation of legal rights and duties, existence of legally enforceable claim is not a prerequisite for an obligation to qualify as a liability if for other reasons the entity has the duty or responsibility to pay cash, to transfer assets, or to provide services to another entity." SFAC No. 6, ¶ 36.

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- 8 The fact that members may not currently know the identity of all investors who are entitled to refunds is not relevant to the determination of whether the refund obligation is a liability. See SFAC No. 6 (explaining that “the identity of the recipient need not be known to the obligated entity before the time of settlement.”).
  - 9 Members should be aware that NASD, in reviewing members’ determinations of their probable liability for the years 2001 and 2002, will use, as a reference for comparison, statistically significant extrapolations of each member’s total liability for that period derived from each member’s data provided in response to the self-assessment. NASD recognizes that a member’s determination of its liability under GAAP may vary from these extrapolations. NASD will communicate to each member that was

subject to the self-assessment its extrapolated total liability for years 2001 and 2002. NASD recognizes that some firms may have refund obligations as a result of transactions that were executed prior to the self-assessment period. In this regard, a significant number of valid customer claims may result in the need for firms to calculate the liability for transactions executed prior to 2001, in accordance with GAAP and SFAC No. 6. The existence of pre-2001 claims and refunds, and the recording of attendant liabilities, may be covered in NASD examinations. In all cases, members should be prepared to demonstrate that the calculation of probable liability is in accordance with GAAP.

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# Notice to Members

AUGUST 2003

## SUGGESTED ROUTING

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

## KEY TOPICS

Bond Mutual Fund Volatility Ratings  
NASD IM-2210-5  
NASD Rule 2210

INFORMATIONAL

## Bond Mutual Fund Volatility Ratings

### SEC Approves Extension of Pilot Relating to Bond Mutual Fund Volatility Ratings

### Executive Summary

On August 7, 2003, NASD filed with the Securities and Exchange Commission (SEC) a proposed rule change to extend for two years the effectiveness of NASD rules that govern the use of bond mutual fund volatility ratings in member sales material. The rule change was effective upon filing. NASD Interpretive Material 2210-5 permits members and associated persons to include bond mutual fund volatility ratings in supplemental sales literature, subject to certain conditions. NASD Rule 2210(c)(3) requires supplemental sales literature containing bond mutual fund volatility ratings to be filed with the Advertising Regulation Department (the Department) for review and approval at least 10 days prior to use.

On February 29, 2000, the SEC approved IM-2210-5 and Rule 2210(c)(3) on an interim 18-month pilot basis. In August 2001, NASD extended the pilot for two-years, until August 31, 2003. The most recent rule filing extends these rules' effectiveness for an additional two years, until August 31, 2005.

Included with this *Notice* is Attachment A (text of rule amendments).

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## Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Joseph P. Savage, Counsel, Investment Companies Regulation, Regulatory Policy and Oversight, at (240) 386-4534, or Philip A. Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451.

## Background

On February 29, 2000, the SEC approved the adoption of NASD Interpretive Material 2210-5, which permits members and their associated persons to include bond fund volatility ratings in supplemental sales literature (mutual fund sales material that is accompanied or preceded by a fund prospectus). The SEC also approved at that time new NASD Rule 2210(c)(3), which sets forth the filing requirements and review procedures applicable to sales literature containing bond mutual fund volatility ratings. Previously, NASD staff interpreted NASD rules to prohibit the use of bond fund volatility ratings in sales material.

IM-2210-5 permits the use of bond fund volatility ratings only in supplemental sales literature and only if certain conditions are met:

- ◆ The word “risk” may not be used to describe the rating.
- ◆ The rating must be the most recent available and be current to the most recent calendar quarter ended prior to use.
- ◆ The rating must be based exclusively on objective, quantifiable factors.
- ◆ The entity issuing the rating must provide detailed disclosure on its rating methodology to investors through a toll-free telephone number, a Web site, or both.
- ◆ A disclosure statement containing all of the information required by the rule must accompany the rating. The statement must include such information as the name of the entity issuing the rating, the most current rating and the date it was issued, and a description of the rating in narrative form containing certain specified disclosures.

Rule 2210(c)(3) requires members to file bond mutual fund sales literature that includes or incorporates volatility ratings with the Department at least 10 days prior to use for Department approval. If the Department requests changes to the material, the material must be withheld from publication or circulation until the requested changes have been made or the material has been re-filed and approved. For a more complete description of IM-2210-5 and Rule 2210(c)(3), please see *Notice to Members 00-23* (April 2000).

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## Extension of Pilot Period

The SEC originally approved IM-2210-5 and new Rule 2210(c)(3) on an 18-month trial basis, until August 31, 2001, to provide NASD an opportunity to assess whether the rule had facilitated the dissemination of useful, understandable information to investors, and whether it had prevented the dissemination of inappropriate and misleading information.

During the initial pilot period, the Department received very few filings pursuant to these provisions. In general, these filings have met the requirements of IM-2210-5. Although these filings generally met the rule's requirements, the staff did not believe that it had received a sufficient number of filings to evaluate adequately the rule's effectiveness. Accordingly, in July 2001, NASD, pursuant to a rule filing with the SEC, extended the pilot for two years.<sup>1</sup> The extended period expires on August 31, 2003.

The Department has continued to receive very few filings under these rules during the extended pilot period. During the entire period from February 2000, when the rule was first approved, until the present, NASD has received a total of 41 submissions from three NASD members. In general, these filings met the requirements of IM-2210-5. However, the staff still does not believe that it has received a sufficient number of filings to adequately evaluate the rule's effectiveness.

In this regard, NASD notes that, because of the low interest rates over the last two years, bond mutual funds may have had little reason to distribute sales material that contains volatility ratings.

Accordingly, NASD is proposing to extend the expiration date of IM-2210-5 and Rule 2110(c)(3) for an additional two years, until August 31, 2005, to allow more filings to be made. The SEC recently published notice of this extension in the Federal Register.<sup>2</sup> Before this period expires, the staff will evaluate the rule and determine whether to recommend that the rule be eliminated, modified, or permanently approved in its current form.

## Endnotes

- 1 See SEC Release No. 34-44737 (Aug. 22, 2001), 66 Fed. Reg. 45350 (Aug. 28, 2001) (SR-NASD-2001-49).
- 2 See SEC Release No. 34-48353 (Aug. 15, 2003), 68 Fed. Reg. 50568 (Aug. 21, 2003) (SR-NASD-2003-126).

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## ATTACHMENT A – RULE TEXT

New text is underlined and deleted text is bracketed.

### 2210. Communications with the Public

\* \* \* \* \*

#### (c) Filing Requirements and Review Procedures

\* \* \* \* \*

##### (3) Sales Literature Containing Bond Fund Volatility Ratings

Sales literature concerning bond mutual funds that include or incorporate bond mutual fund volatility ratings, as defined in Rule IM-2210-5, shall be filed with the Department for review at least 10 business days prior to use (or such shorter period as the Department may allow in particular circumstances) for approval and, if changed by NASD, shall be withheld from publication or circulation until any changes specified by NASD have been made or, if expressly disapproved, until the sales literature has been refiled for, and has received, NASD approval. Members are not required to file advertising and sales literature which have previously been filed and which are used without change. The member must provide with each filing the actual or anticipated date of first use. Any member filing sales literature pursuant to this paragraph shall provide any supplemental information requested by the Department pertaining to the rating that is possessed by the member.

\* \* \* \* \*

#### IM-2210-5. Requirements for the Use of Bond Mutual Fund Volatility Ratings

(This rule and Rule 2210(c)(3) will expire on August 31, [2003] 2005, unless extended or permanently approved by [the Association] NASD at or before such date.)

##### (a) Definition of Bond Mutual Fund Volatility Ratings

For purposes of this Rule and any interpretation thereof, the term “bond mutual fund volatility rating” is a description issued by an independent third party relating to the sensitivity of the net asset value of a portfolio of an open-end management investment company that invests in debt securities to changes in market conditions and the general economy, and is based on an evaluation of objective factors, including the credit quality of the fund’s individual portfolio holdings, the market price volatility of the portfolio, the fund’s performance, and specific risks, such as interest rate risk, prepayment risk, and currency risk.

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**(b) Prohibitions on Use**

Members and persons associated with a member may use a bond mutual fund volatility rating only in supplemental sales literature and only when the following requirements are satisfied:

(1) The rating does not identify or describe volatility as a “risk” rating.

(2) The supplemental sales literature incorporates the most recently available rating and reflects information that, at a minimum, is current to the most recently completed calendar quarter ended prior to use.

(3) The criteria and methodology used to determine the rating must be based exclusively on objective, quantifiable factors. The rating and the Disclosure Statement that accompanies the rating must be clear, concise, and understandable.

(4) The supplemental sales literature conforms to the disclosure requirements described in paragraph (c).

(5) The entity that issued the rating provides detailed disclosure on its rating methodology to investors through a toll-free telephone number, a web site, or both.

**(c) Disclosure Requirements**

(1) Supplemental sales literature containing a bond mutual fund volatility rating shall include a Disclosure Statement containing all the information required by this Rule. The Disclosure Statement may also contain any additional information that is relevant to an investor’s understanding of the rating.

(2) Supplemental sales literature containing a bond mutual fund volatility rating shall contain all current bond mutual fund volatility ratings that have been issued with respect to the fund. Information concerning multiple ratings may be combined in the Disclosure Statement, provided that the applicability of the information to each rating is clear.

(3) All bond mutual fund volatility ratings shall be contained within the text of the Disclosure Statement. The following disclosures shall be provided with respect to each such rating:

(A) the name of the entity that issued the rating;

(B) the most current rating and date of the current rating, with an explanation of the reason for any change in the current rating from the most recent prior rating;

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(C) a description of the rating in narrative form, containing the following disclosures:

(i) a statement that there is no standard method for assigning ratings;

(ii) a description of the criteria and methodologies used to determine the rating;

(iii) a statement that not all bond funds have volatility ratings;

(iv) whether consideration was paid in connection with obtaining the issuance of the rating;

(v) a description of the types of risks the rating measures (e.g., short-term volatility);

(vi) a statement that the portfolio may have changed since the date of the rating; and

(vii) a statement that there is no guarantee that the fund will continue to have the same rating or perform in the future as rated.

# Disciplinary and Other NASD Actions

## REPORTED FOR AUGUST

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 July 2003.

### Firm Expelled, Individual Sanctioned

**Key West Securities, Inc. (CRD #38305, Cardiff by the Sea, California) and Amr "Tony" Elgindy (CRD #1824634, Registered Representative, Colleyville, Texas)** were fined \$51,000, jointly and severally. Elgindy was barred from association with any NASD member in any capacity, and the firm was expelled from NASD membership. The National Adjudicatory Council (NAC) imposed the sanctions following appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that the firm and Elgindy engaged in a manipulation scheme when Elgindy posted artificially high bids that were designed to inflate the price of a stock. The firm and Elgindy also inserted high bids without intending to honor them. In addition, the firm and Elgindy failed to disclose that the firm was making a market in a security or that it would sell to, or buy from, customers on a principal basis.

Elgindy and the firm have appealed this action to the U.S. Securities and Exchange Commission (SEC). The sanctions, except for the bar and expulsion, are not in effect pending consideration of the appeal. (NASD Case #CMS000015)

### Firm Suspended

**Schneider Securities, Inc. (CRD #16434, Denver Colorado)** submitted an Offer of Settlement in which the firm was suspended from all trading activities for two years. In light of the financial status of the firm, no monetary sanctions have been imposed. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it transmitted to the NASDAQ Stock Market, Inc., through the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>), last-sale reports of fictitious transactions in a NASDAQ National Market® (NNM) security. The findings also stated that the firm reported these fictitious transactions in an NNM security with the intent to cause the market for the stock to attain a higher price. NASD also found that the firm engaged in a manipulative, deceptive, and/or fraudulent conduct by intentionally or recklessly causing to be reported to the NASDAQ Stock Market, Inc., last-sale reports of transactions in a common stock for the purpose of affecting the price in the security. In addition, NASD found that the firm published and circulated, or caused to be published and circulated, communications through last-sale reports to ACT of fictitious transactions in a common stock that the firm did not believe were bona fide purchases or sales. Furthermore, the findings stated that the firm failed to

establish, maintain, or enforce procedures reasonably designed to ensure that it reported only bona fide transactions in the last-sale reports it reported to the NASDAQ Stock Market, Inc., through ACT. The findings also included that the firm failed to have in place procedures to adequately review trades reported to ACT, or to ensure that its employee did not report fictitious trades to ACT.

The firm's suspension began July 21, 2003, and will conclude at the close of business July 20, 2005. (NASD Case #CMS030001)

## Firm Expelled, Individual Sanctioned

**Patterson Travis, Inc. (CRD #16540, Englewood, Colorado) and David Thomas Travis (CRD #448950, Registered Principal, Aurora, Colorado)** The firm was fined \$50,000 and expelled from NASD membership, and Travis was fined \$50,000 and barred from association with any NASD member in any capacity. The sanctions were based on findings that the firm, acting through Travis, contravened SEC Rules 15g-2, 15g-3, and 15g-5, in that prior to effecting transactions in a penny stock for the accounts of public customers, the firm did not furnish to the customers a penny stock transactions risk disclosure statement and did not obtain from the customers a manually signed and dated written acknowledgement of receipt of the document. The findings also stated that the firm, acting through Travis, prior to effecting transactions in a penny stock for customers' accounts or in writing at the time of confirmation, did not disclose to customers the inside bid quotation and the inside offer quotation for the penny stock, and did not disclose to customers the aggregate amount of cash compensation to its associated persons in connection with these transactions.

In addition, the findings stated that the firm did not obtain a written agreement setting forth the identity and quantity of a penny stock to be purchased and a signed and dated written statement from each purchaser relating to the purchaser's financial condition, investment experience, and investment objectives. NASD found that the firm, acting through Travis, failed to supervise properly the sale of a penny stock by registered representatives to achieve compliance with applicable securities laws, regulations, and NASD rules. Furthermore, NASD found that the firm and Travis attempted to conceal their violation of the penny stock rules and to obstruct an NASD investigation. In addition, NASD found that the firm and Travis failed to comply with the terms of an Order of Settlement that involved, among other things, violations of the Penny Stock Rules. (NASD Case #C06020003)

## Firms Fined, Individuals Sanctioned

**American Heritage Church Finance, Inc. (CRD #18285, Orlando, Florida) and Bryant Forrest Thompson (CRD #1127521, Registered Principal, Orlando, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$40,000, of which \$25,000 was assessed jointly and severally with Thompson. Thompson was also suspended from association with any NASD member in any capacity for 90 days. Without admitting or denying the allegations, the firm and Thompson consented to the described sanctions and to the entry of findings that the firm participated in church bond offerings wherein pursuant to the offering materials, funds received from the sale of the church bonds would be placed in an escrow account and not be released until a minimum contingency was met. The findings also stated that the firm, acting through Thompson, caused funds to be released from the escrow account before the minimum contingency was reached, thereby rendering the representations in the offering materials false. NASD also found that the firm, acting through Thompson, failed to ensure that customer records contained information required by NASD Conduct Rule 3110c. In addition, NASD found that the firm, acting through Thompson, failed to establish, maintain, and enforce a supervisory system reasonably designed to achieve compliance with SEC and NASD rules.

Thompson's suspension began July 21, 2003, and will conclude October 18, 2003. (NASD Case #C07030043)

**D.R. Mayo & Co., Inc. (CRD #8658, San Francisco, California) and Donald Richard Mayo (CRD #324176, Registered Principal, Piedmont, California)** submitted an Offer of Settlement in which the firm was censured and fined \$10,000, jointly and severally with Mayo. Mayo was barred from association with any NASD member in a principal or supervisory capacity. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm and Mayo failed to establish, maintain, and enforce written procedures reasonably designed to achieve compliance with NASD rules and to otherwise supervise an individual. (NASD Case #C01020025)

**Your Discount Brokers, Inc. (CRD #25438, Boca Raton, Florida) and Michael Silverstein (CRD #2012130, Registered Principal, Coral Springs, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$17,500. Silverstein was fined \$75,000 and suspended from association with any NASD member in any capacity for two months. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Silverstein recklessly and/or intentionally entered priced day orders to buy 100 shares of stock into the order delivery and execution system of the firm's clearing firm at prices that Silverstein knew, or should have known, would improve the National Best Bid (NBB) for the stock, in that the full price and size of such order would be reflected in

the public quotation stream as the best prices and sizes at which a market participant was willing to buy shares of the stock. The findings stated that the entering of such orders by Silverstein was manipulative, deceptive, and/or fraudulent conduct, and that he entered such orders at prices that were higher than the previous NBB for the stock within 2 to 28 seconds before the close of the trading day. NASD also found that each of the 29 priced orders that Silverstein entered to purchase shares of the company became the closing bid in the company, and, as a result of this conduct, Silverstein was able to cause market appreciation in his margin account at the firm in the aggregate amount of \$251,553.13 and, by virtue of the manner in which the firm's clearing firm calculated margin liabilities, to decrease the amount of his margin exposure in his margin account. In addition, the findings stated that the firm failed to establish a supervisory system reasonably designed to achieve compliance with applicable securities laws and regulations concerning quotation and trading activity at or near the close of the trading day.

Silverstein's suspension began July 7, 2003, and will conclude September 6, 2003. (NASD Case #CMS030135)

## Firms and Individuals Fined

**Morgenthau & Associates, Inc. (CRD #6586, Ft. Lauderdale, Florida) and Anthony Reginald Morgenthau (CRD #340142, Registered Principal, Coral Gables, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$13,000, jointly and severally. Without admitting or denying the allegations, the firm and Morgenthau consented to the described sanctions and to the entry of findings that the firm, acting through Morgenthau, began a best-efforts underwriting and, after raising approximately \$2.5 million from public investors, issued amendments changing the terms of the offering by extending the termination date of the offering and raising the maximum dollar amount of the offering. The findings also stated that the firm failed to give notice of the changes to the original investors, failed to provide them with copies of the amendments, and failed to provide them an opportunity to reaffirm or rescind their purchases. (NASD Case #C07030039)

**U.S. Clearing Corp. (CRD #13071, New York, New York) and Leslie Charles Quick, III (CRD #1079748, Registered Principal, Bernardsville, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$75,000, jointly and severally. Without admitting or denying the allegations, the firm and Quick consented to the described sanctions and to the entry of findings that the firm, acting through Quick, entered into agreements with a correspondent member firm that enabled the firm to misclassify certain funds as allowable assets for net capital purposes on its FOCUS reports and other financial documents. The findings also stated that the firm prepared inaccurate financial records in connection with the agreements. (NASD Case #C10030050)

## Firms Fined

**Bear Stearns & Company, Inc. (CRD #79, Whippany, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in OTC Equity and Consolidated Quotation Service ("CQS") securities. The findings also stated that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in OTC Equity and CQS securities and failed to designate through ACT such last-sale reports as late. In addition, NASD found that the firm incorrectly designated as .SLD through ACT last-sale reports of transactions in OTC Equity and CQS securities reported to ACT within 90 seconds of execution. (NASD Case #CMS030141)

**First Clearing Corporation (CRD #17344, Glen Allen, Virginia)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in NASDAQ National Market, NASDAQ SmallCap, and OTC Equity securities. The findings also stated that the firm incorrectly designated as ".T" through ACT last-sale reports of transactions in OTC Equity securities executed during normal market hours. (NASD Case #CMS030144)

**Huberman Financial Inc. (CRD #28760, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that as a market maker in securities, it caused a locked/crossed market condition prior to the market opening by entering a bid (ask) quotation that locked/crossed another market maker's quotations without immediately thereafter sending through SelectNet to the market maker(s) whose quote(s) it locked or crossed a Trade-or-Move message(s) that was at the receiving market maker's quoted price and whose aggregate size was at least 5,000 shares. The findings also stated that the firm was a party to a locked or crossed market condition prior to the market opening and received a Trade-or-Move message in each instance through SelectNet, and, within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. (NASD Case #CMS030136)

**J. P. Morgan Invest, LLC (CRD #1326, Boston, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its supervisory procedures concerning locked and crossed markets within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it entered a priced order into an Electronic Communications Network (ECN) that was displayed in The NASDAQ Stock Market at a price that caused a locked or crossed market condition to occur in each instance, without making reasonable efforts to avoid a locked or crossed market by attempting to execute transactions with all market makers whose quotations would be locked or crossed. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to the applicable securities laws and regulations concerning locked and crossed markets. **(NASD Case #CMS030140)**

**J.P. Morgan Securities Inc. (CRD #18718, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$50,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, it was a party to a locked or crossed market condition prior to the market opening, and received a Trade-or-Move message in each instance through SelectNet and, within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. The findings also stated that the firm was a registered market maker in securities, that an order was presented to the firm at the firm's published bid or published offer in an amount up to its published quotation size, and that the firm failed to execute the orders upon presentment and thereby failed to honor its published quotation. Furthermore, NASD found that the firm failed to show certain terms and conditions on the memorandum of brokerage orders in connection with orders received on the first day of secondary trading immediately following 12 initial public offerings (IPOs). **(NASD Case #CMS030150)**

**Ladenburg, Thalmann & Company, Inc. (CRD #505, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured; fined \$92,500; required to pay \$3,674.54, plus interest, in restitution to a public customer; and required to revise its written supervisory procedures concerning firm quote compliance, registration and qualifications of trading supervisors, order handling and execution, best execution of internal agency orders, anti-competitive practices, short sales, locked and crossed markets, Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>), record keeping, SEC Rule 15c2-11, and NASD Marketplace Rule 6740 within 30 business days.

Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in securities, an order was presented to the firm at the firm's published bid or published offer in an amount up to its published quotation size, and the firm failed to execute the orders upon presentment and thereby failed to honor its published quotation. The findings also stated that the firm, as a market maker in securities, was a party to a locked or crossed market condition prior to the market opening, received a Trade-or-Move message in each instance through SelectNet, and, within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. NASD also found that the firm failed to contemporaneously or partially execute customer limit orders in NASDAQ securities after it traded each subject security for its own market-making account at a price that would have satisfied each customer's limit order; and the firm executed a short-sale transaction and failed to report the transaction to ACT with a short-sale modifier and as an exempt short sale.

Furthermore, the findings stated that the firm failed to accept or decline in ACT transactions in an eligible security within 20 minutes after execution; to report to ACT the correct symbol indicating whether the firm executed transactions in eligible securities in a principal or agency capacity; to correct execution time for transaction in an eligible security; and to correct the symbol indicating whether the transaction was a buy, sell, sell short, sell short exempt, or cross for transactions in eligible securities. In addition, NASD found that the firm incorrectly designated transactions as riskless to ACT and failed to submit, for the offsetting, "riskless" portion of "riskless" principal transaction(s) in CQS and OTCBB securities, either a clearing-only report with a capacity indicator of "riskless principal," or a non-tape, non-clearing report with a capacity indicator of "riskless principal." NASD also determined that the firm failed to display immediately the customer limit orders in NASDAQ securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer in such security, and the size of the order represented more than a de minimis change in relation to the size associated with its bid or offer in each such security.

In addition, the findings stated that the firm failed to preserve for a period of not less than three years, with the first two being in an accessible place, the memorandum of seven brokerage orders, and failed to show the times of entry on the memorandum of six brokerage orders and on the volumes of multiple partial executions of a customer's order on the memorandum of two brokerage orders. NASD further found that, in transactions for or with a customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the

resultant price to its customer was as favorable as possible under prevailing market conditions. The findings stated that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in NNM securities, failed to designate through ACT such last-sale reports as late, and failed to report through ACT last-sale reports of transactions and the correct price of the transaction in NNM securities. NASD also found that the firm published quotations for an OTC Equity Security, or, directly or indirectly, submitted such quotations for publication in a quotation medium and did not have in its records the documentation required by SEC Rule 15c2-11(a) ("paragraph (a) information"); did not have a reasonable basis under the circumstances for believing that the paragraph (a) information was accurate in all material respects; or did not have a reasonable basis under the circumstances for believing that the sources of the paragraph (a) information were reliable.

The findings also stated that the firm failed to file a Form 211 with NASD at least three business days before the firm's quotations were published or displayed in a quotation medium and failed to properly classify orders as "covered" or "not covered" for purposes of calculating its monthly data report pursuant to SEC Rule 11Ac1-5. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning firm quote compliance, registration and qualifications of trading supervisors, order handling and execution, best execution of internal agency orders, anti-competitive practices, short sales, locked and crossed markets, OATS, record keeping, SEC Rule 15c2-11, and NASD Marketplace Rule 6740. (NASD Case #CMS030153)

**Magna Securities Corporation (CRD #30935, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$15,000, and required to revise its supervisory procedures concerning ACT trade reporting within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in eligible securities. The findings also stated that the firm also incorrectly designated as ".SLD," through ACT, these last-sale reports of transactions in eligible securities reported to ACT within 90 seconds of execution. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning ACT trade reporting. (NASD Case #CMS030127)

**Merrill Lynch, Pierce, Fenner & Smith Inc. (CRD #7691, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$12,500, and required to revise its supervisory procedures concerning obtaining and documenting three quotations in non-NASDAQ securities within 30 days. Without admitting or denying the allegations, the firm consented to the described sanctions and to

the entry of findings that in connection with transactions in non-NASDAQ securities, it failed to contact and obtain quotations from three dealers to determine the best inter-dealer market for each subject security. The findings stated that the firm failed to display immediately customer limit orders in NASDAQ securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer for each such security, and the size of the order represented more than a de minimis change in relation to the size associated with the firm's bid or offer in each such security. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning obtaining and documenting three quotations in non-NASDAQ securities. (NASD Case #CMS030142)

**OTA LLC (CRD #25816, Purchase, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$15,000, and required to revise its supervisory procedures concerning OATS reporting within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to submit required information to OATS on 15 business days. The findings also stated that the firm transmitted to OATS execution reports that contained inaccurate, incomplete, or improperly formatted data, and submitted to OATS Reportable Order Events (ROEs) with respect to equity securities traded on The NASDAQ Stock Market that were not in the electronic form prescribed by NASD. Furthermore, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning OATS reporting. (NASD Case #CMS030143)

**Penson Financial Services, Inc. (CRD #25866, Dallas, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$25,000. The firm was also required to retain an independent consultant to conduct a review of and to prepare written reports 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 the entry of findings that it failed to establish and maintain a supervisory system reasonably designed to address the processing of letters of authorization received from its correspondent firms. (NASD Case #C06030011)

**Primex (CRD #29394, Hempstead, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it permitted an individual to perform duties as a general securities principal while his

registration status with NASD was inactive due to his failure to timely complete the Regulatory Element of NASD's Continuing Education Rule. The findings also stated that the firm, acting through an individual, failed to comply with the terms of its Membership Agreement, in that it failed to file a written notice to NASD at least 30 days in advance regarding a change in ownership of the firm and failed to notify promptly NASD of its intent to open a branch office. In addition, NASD found that the firm, acting through an individual, failed to file an application for approval to NASD at least 30 days in advance regarding a change in ownership of the firm. Furthermore, the findings stated that the firm, acting through an individual, failed to establish and maintain a supervisory system over the activities of a branch office reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD Rules, in that the firm, acting through an individual, permitted the individual's NASD Electronic Signature and password to be used by a person at the firm who was not a registered principal, and permitted new accounts to be opened and orders to be executed through a branch office without the approval of a principal of the firm. (NASD Case #C8A030049)

**RBC Dain Rauscher, Inc. (CRD #31194, Minneapolis, Minnesota)** 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, as a market maker in the securities, it was a party to a locked or crossed market condition prior to the market opening and entered a pre-opening bid (offer) quotation that was equal to or greater (less) than the pre-opening asked (bid) quotation of another market maker entering quotations in the same securities, and failed to send immediately through SelectNet® a Trade-or-Move message to the market maker whose quotations it locked or crossed for at least 5,000 shares in aggregate. In addition, the findings stated that the firm was a party to a locked or crossed market condition prior to the market opening and failed, within 30 seconds of receiving a Trade-or-Move Message, either to fill the incoming Trade-or-Move Message for the full size of the message or to move its bid down (offer up) by a quotation increment that would unlock/uncross the market. (NASD Case #CMS030147)

**Swift Trade Securities, Inc. (CRD #45141, Toronto, Ontario)** 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. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning the execution and reporting of short-sale transactions. (NASD Case #CMS030134)

**TD Securities (USA) Inc. (CRD #18476, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report to the Fixed Income Pricing System<sup>SM</sup> (FIPS SM) transactions in FIPS securities within five minutes after execution. The findings also stated that the firm incorrectly reported to FIPS transactions in FIPS securities and in high-yield securities that the firm should not have reported to FIPS under the FIPS rules. (NASD Case #CMS030145)

**USB Securities LLC (CRD #7654, Stamford, Connecticut)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$72,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that, as a market maker in the securities, without making reasonable efforts to avoid a locked or crossed market by executing transactions with all market makers whose quotations would be locked or crossed, it entered bid or ask quotations in The NASDAQ Stock Market, which caused a locked or crossed market condition to occur in each instance. NASD found that an order was presented to the firm at the firm's published bid or published offer in an amount up to its published quotation size, and the firm failed to execute the orders upon presentment and thereby failed to honor its published quotation. The findings also stated that the firm caused a locked/crossed market condition prior to the market opening by entering a bid (ask) quotation that locked/crossed another market maker's quotations without immediately thereafter sending through SelectNet, to the market maker(s) whose quotes it locked or crossed, a Trade-or-Move message(s) that was at the receiving market maker's quoted price and whose aggregate size was at least 5,000 shares.

In addition, the findings stated that the firm was a party to a locked or crossed market condition prior to the market opening, and received a Trade-or-Move message in each instance through SelectNet and within 30 seconds of receiving such messages, failed to fill the incoming Trade-or-Move message for the full size of the message or move its bid down (offer up) by a quotation increment that would have unlocked/uncrossed the market. Furthermore, NASD found that the firm failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in OTC Equity securities, and failed to designate through ACT such last-sale reports as late. The findings also stated that the firm reported to ACT last-sale reports of transactions in OTC Equity securities on an "as of" basis when electronic submission on the trade date of such transactions was possible through ACT, and incorrectly designated as ".PRP" through ACT last-sale reports of transactions in OTC Equity securities. NASD further found that the firm transmitted to OATS reports that contained inaccurate, incomplete, or improperly formatted data; specifically, these reports omitted the Account Type Code. (NASD Case #CMS030155)

## Individuals Barred or Suspended

**Emmett Maurice Abercrombie (CRD #307, Registered Representative, Atlanta, Georgia)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Abercrombie consented to the described sanction and to the entry of findings that he participated in private securities transactions without providing written notice to, and obtaining written approval from, his member firm. The findings also stated that Abercrombie intentionally failed to disclose information to his member firm regarding sales of units in a private placement offering to public customers. (NASD Case #C07030020)

**Gregory Lee Adams (CRD #4561328, Associated Person, Santa Clarita, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. The fine must be paid before Adams reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Adams consented to the described sanctions and to the entry of findings that he willfully misrepresented material facts on his Uniform Application for Securities Industry Registration or Transfer Form (Form U4).

Adams' suspension will begin August 18, 2003, and will conclude at the close of business October 16, 2003. (NASD Case #C02030039)

**Mark Paul Adler (CRD #2194735, Registered Representative, West Orange, New Jersey)** was fined \$20,000 and suspended from association with any NASD member in any capacity for 18 months. The fine must be paid before Adler reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. The sanctions were based on findings that Adler had a personal account with his member firm in which he traded equities. The findings stated that Adler's firm imposed a 90-day restriction on Adler's account, and that while the restriction was in effect, Adler was not allowed to make a purchase in his account unless a principal of his member firm had confirmed that Adler had enough money in his account to pay for the trade. NASD also found that Adler signed the initials of a principal on an order ticket for purchases in his account without authorization.

Adler's suspension began July 7, 2003, and will conclude at the close of business January 6, 2005. (NASD Case #C9B020060)

**Anthony William Allen (CRD #1653113, Registered Principal, Warren, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the

allegations, Allen consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, and failed to provide his member firm with prompt written notice of his outside business activities.

Allen's suspension began July 21, 2003, and will conclude at the close of business August 19, 2003. (NASD Case C8B030013)

**Gregory Wylan Anderson (CRD #2113685, Registered Principal, Fort Collins, Colorado)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and ordered to disgorge commissions earned in partial restitution to the customers in the amount of \$209,345. Without admitting or denying the allegations, Anderson consented to the described sanctions and to the entry of findings that he participated in activities outside the scope of his employment with his member firm and failed to provide his firm with prompt written notice of his activities. (NASD Case #C3A030011)

**Sawsan Anis Bardissi (CRD #2815723, Registered Representative, Lansdale, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Bardissi consented to the described sanction and to the entry of findings that, while associated with her member firm, she dated and altered dates on Regulation 60 documents so as to give the false impression that two meetings had occurred when, in fact, only one meeting had occurred. The findings also stated that Bardissi failed to respond to NASD requests to appear for on-the-record interviews. (NASD Case #C9B030039)

**Kyle Leon Baxter (CRD #4515485, Registered Representative, Allegan, Michigan)** 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, Baxter consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form U4. The findings also stated that Baxter failed to respond to NASD requests for information. (NASD Case #C8A030047)

**Patricia Ann Bennett (CRD #2663117, Registered Representative, Kearney, Nebraska)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Bennett consented to the described sanction and to the entry of findings that she converted \$96,774.19 from customer accounts by writing checks to withdraw funds from their securities accounts, and that she made unauthorized transfers from their accounts and deposited said funds into bank and securities accounts under her control. (NASD Case #C04030036)

**Leonard Joseph Bertucci (CRD #1936823, Registered Representative, Torrance, 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, Bertucci consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. (NASD Case #C02030034)

**Axel Rolando Bonilla (CRD #2337142, Registered Representative, Paterson, 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, Bonilla consented to the described sanction and to the entry of findings that he received checks from a public customer in the amount of \$165,000, payable to a firm intended for investment in securities. The findings stated that Bonilla, instead of investing the customer's funds, misused such funds for other purposes without the customer's permission or authority to use the funds in this manner. NASD also found that Bonilla created and gave to the customer a false account statement reflecting the customer's purported securities holdings. (NASD Case #C9B030040)

**Robert Alan Brannon (CRD #2662633, Registered Representative, Vancouver, Washington)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for four months. In light of the financial status of Brannon, no monetary sanctions have been imposed. Without admitting or denying the allegations, Brannon consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firm.

Brannon's suspension began July 21, 2003, and will conclude at the close of business November 20, 2003. (NASD Case #C3B030010)

**Richard Breglia (CRD #4571975, Registered Representative, Greenwich, Connecticut)** 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, Breglia consented to the described sanction and to the entry of findings that he willfully failed to disclose material facts on his Form U4. (NASD Case #C11030023)

**Terrance Gary Buyze (CRD #2317177, Registered Representative, Traverse City, Michigan)** 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, Buyze consented to the described sanction and to the entry of findings that he failed and neglected to give written notice of his intention to engage in a private securities transaction by participating in the

sale of securities for compensation, and failed to receive written approval from his member firm prior to engaging in such activities. The finding also states that Buyze failed and neglected to provide prompt, written notice to his member firm of his outside business activities, in that he accepted compensation from another company for the sale of tax-qualified long-term care insurance policies to public customers. NASD also found that Buyze failed to respond fully to NASD requests for information and documents. (NASD Case #C8A030054)

**David Weenam Chinn (CRD #2158472, Registered Representative, Elk Grove, California)** submitted an Offer of Settlement in which he was fined \$39,785 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Chinn reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Chinn consented to the described sanctions and to the entry of findings that he participated in outside business activities for compensation without providing prompt written notification to his member firm.

Chinn's suspension began August 4, 2003, and will conclude at the close of business February 3, 2004. (NASD Case #C01030003)

**Phillip John Chipping (CRD #4024959, Registered Representative, Salt Lake City, Utah)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,786.44, including disgorgement of commissions received of \$15,786.44, ordered to pay \$157,901 in restitution to a public customer, and suspended from association with any NASD member in any capacity for one year. The fine and restitution must be paid before Chipping reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Chipping consented to the described sanctions and to the entry of findings that he made recommendations to a customer to liquidate securities and to purchase variable annuities without having a reasonable basis for believing these recommendations were suitable for the customer in light of the customer's circumstances, needs, and other security holdings.

Chipping's suspension began August 4, 2003, and will conclude at the close of business August 3, 2004. (NASD Case #C3A030026)

**Douglas Royce Cochrane (CRD #3244003, Registered Representative, Boca Raton, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 15 business days. The fine must be paid before Cochrane reassociates with any NASD member following the suspension or before requesting relief from any statutory

disqualification. Without admitting or denying the allegations, Cochrane consented to the described sanctions and to the entry of findings that he engaged in outside business activities outside the scope of his relationship with his member firm, and failed to provide written notice of his intent to participate in the business activity to his member firm.

Cochrane's suspension began July 21, 2003, and concluded at the close of business August 8, 2003. (NASD Case #C07030040)

**George Michael DiFuilo (CRD #2689129, Registered Principal, Staten Island, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, ordered to disgorge commissions in partial restitution to a public customer in the amount of \$46,458.48, and suspended from association with any NASD member in any capacity for six months. The fine and restitution must be paid before DiFuilo reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, DiFuilo 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 objective.

DiFuilo's suspension began August 4, 2003, and will conclude at the close of business February 3, 2004. (NASD Case #C9B030044)

**Douglas Paul Dillmann (CRD #1787564, Registered Representative, Chicago, Illinois)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Dillmann engaged in outside business activities by receiving compensation without providing written notice to his member firm, and that he failed to respond timely and completely to NASD requests for information. (NASD Case #C8A030006)

**Mark Christopher Donato (CRD #1018583, Registered Representative, Pittsburgh, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for 25 business days. Without admitting or denying the allegations, Donato consented to the described sanctions, and to the entry of findings that he recommended that public customers exchange 100 percent of the funds each had invested in sub-accounts within variable annuities into a sub-account within annuities involving a growth fund, without having reasonable grounds to believe that his recommendations and resultant transactions were suitable for the customers based on their financial situation, investment objectives, and needs. The findings also stated that Donato told a customer that he would compensate her for any losses in her variable annuities account.

Donato's suspension began August 4, 2003, and will conclude at the close of business September 8, 2003. (NASD Case #C9A030021)

**Paul Hanson Dustman (CRD #4375429, Registered Representative, Napa, 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, Dustman consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. (NASD Case #C02030041)

**Vincent John Gallo (CRD #851192, Registered Representative, Clemmons, North Carolina)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$17,500, including disgorgement of \$11,672.21 in commissions received, and suspended from association with any NASD member in any capacity for 90 days. The fine must be paid before Gallo reassociates with any NASD member in any capacity following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Gallo consented to the described sanctions and to the entry of findings that he engaged in a private securities transaction for compensation, and failed to provide his member firm with prior written notice of his intentions and to receive approval from his member firm.

Gallo's suspension began July 21, 2003, and will conclude October 18, 2003. (NASD Case #C07030044)

**Allen Norman Ginesin (CRD #222161, Registered Representative, Bethel, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity and required to pay \$4,500 in restitution, plus interest, to a public customer. The restitution must be paid before Ginesin reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Ginesin consented to the described sanctions and to the entry of findings that he misused \$4,500 received from a public customer for investment in a private placement of securities. (NASD Case #C11030020)

**Kenneth Lawrence Gliwa (CRD #1087236, Registered Principal, Smithtown, 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, Gliwa consented to the described sanction and to the entry of findings that he failed to supervise reasonably the activities in his member firm's branch office in that he allowed two unregistered persons to hire brokers and independently operate the office. The findings also stated that Gliwa directed his firm's trading desk to follow the instructions of the unregistered persons that resulted in three orders being routed to another company. In addition, NASD found that Gliwa failed to conduct any meaningful review of the

securities to determine whether they were suitable investments for the customers, and he allowed the firm to operate without any written supervisory procedures. (NASD Case #CMS030148)

**Michael Anthony Gonzalez (CRD #2515811, Registered Representative, Pasadena, 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, Gonzalez consented to the described sanction and to the entry of findings that he received \$27,200 from a public customer to be invested, and instead of applying the funds as directed, he misused the funds for a period of time before returning the misused funds to the customer. (NASD Case #C02030038)

**Sherry Lynn Grenier (CRD #1972967, Registered Representative, White Plains, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$10,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Grenier reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Grenier consented to the described sanctions and to the entry of findings that she signed customer signatures on Letters of Authorization (LOAs) at the request of, and as an accommodation to, public customers to effect transfers of client funds or assets that were approved by the customers and did not result in misappropriation or any other customer harm. The findings also stated that Grenier failed to disclose to her member firm that she had signed the customer signatures on the LOAs. NASD also found that Grenier failed to reasonably supervise sales assistants in a branch office under her supervision and failed to enforce the firm's written supervisory procedures regarding the completion of LOAs and other firm-transfer forms.

Grenier's suspension began July 21, 2003, and will conclude at the close of business July 20, 2004. (NASD Case #C10030043)

**Charles Christian Grinkmeyer (CRD #2906437, Registered Representative, Vestavia Hills, Alabama)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 15 days. Without admitting or denying the allegations, Grinkmeyer consented to the described sanctions and to the entry of findings that he recommended and effected transactions in the account of a public customer without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customer on the basis of her financial situation and needs. The findings also stated that Grinkmeyer executed transactions in the account of a public customer using time and price discretion verbally granted by the customer without reconfirming the client's continued desire to effectuate the transactions, and

without having obtained prior written authorization from the customer to conduct discretionary trades and written acceptance of the account as discretionary from his member firm.

Grinkmeyer's suspension began August 4, 2003, and will conclude at the close of business August 18, 2003. (NASD Case #C05030032)

**Ralph Timothy Grubb (CRD #1528906, Registered Representative, Johnson City, Tennessee)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for 15 business days. In light of the financial status of Grubb, no monetary sanction has been imposed. Without admitting or denying the allegations, Grubb consented to the described sanction and to the entry of findings that he recommended and effected transactions to public customers without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customer on the basis of her financial situation and needs.

Grubb's suspension began August 4, 2003, and will conclude at the close of business August 22, 2003. (NASD Case #C05030019)

**Frank Hilary Hickcox, II (CRD #2676308, Registered Principal, Santa Ana, 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, Hickcox consented to the described sanction and to the entry of findings that, without the prior knowledge, authorization, or consent from public customers, he executed and/or caused to be executed unauthorized transactions in the customers' accounts. The findings also stated that Hickcox, when confronted by the customers about the unauthorized transactions, misrepresented to the customers that the trades had or would be cancelled when in fact they were not, and provided the customers with false reports purported to be from the clearing firm with which he did business, but were created without the firm's knowledge or consent. (NASD Case #C02030037)

**Ian-Max Henriquez (CRD #4011853, Registered Representative, Los Angeles, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Henriquez consented to the described sanctions and to the entry of findings that he engaged in business activities for compensation outside the scope of his member firm, and failed to provide prompt written notification of the transactions to his member firm.

Henriquez' suspension began August 4, 2003, and concluded at the close of business August 15, 2003. (NASD Case #C02030035)

**Stephen W. Hill (CRD #4319575, Registered Representative, Beach, North Dakota)** 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, Hill consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. **(NASD Case #C04030033)**

**Rolando Julian Jarvis (CRD #2703213, Registered Principal, Deer Park, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Jarvis consented to the described sanction and to the entry of findings that he converted and/or misused \$550,100 of customers' funds intended for investment purposes without the knowledge, authorization, or consent of the customers. The findings also stated that Jarvis failed to respond to NASD requests for information. **(NASD Case #C04030034)**

**Michael Norman Kane, II (CRD #2167829, Registered Representative, Pleasant Hill, 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, Kane consented to the described sanction and to the entry of findings that he converted \$20,704.90 of customer funds by withdrawing funds from the customer's securities account with blank checks signed by the customer and depositing said funds into his own personal bank account. The findings also stated that Kane failed to respond to NASD requests for information. **(NASD Case #C04030037)**

**Mark Elliot Kastan (CRD #2580106, Registered Representative, Montvale, New Jersey) and Martin Baron Dropkin (CRD #4027393, Registered Representative, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which Kastan was fined \$50,000 and suspended from association with any NASD member in any capacity for 10 business days. Dropkin was censured and fined \$25,000. Without admitting or denying the allegations, Kastan and Dropkin consented to the described sanctions and to the entry of findings that they wrote and published research reports that failed to disclose adequately risks regarding a broadband telecommunications service provider, particularly that the provider needed to raise more than \$3 billion to reach a free cash flow positive status and that it might not be able to raise the necessary funds. The findings also stated that Kastan and Dropkin recommended the purchase of the provider's common stock with a "strong buy" rating without a reasonable basis for the 12-month target price per share contained in the reports.

Kastan's suspension began July 21, 2003, and concluded August 1, 2003. **(NASD Case #CAF030034)**

**Evan Lewis Kaye (CRD #2459633, Registered Representative, New York, New York)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and required to pay \$665,071.17, plus interest, in restitution to customers. Satisfactory proof of payment of restitution must be made before Kaye reassociates with any NASD member. Without admitting or denying the allegations, Kaye consented to the described sanctions and to the entry of findings that he executed unauthorized transactions in the accounts of public customers without their prior knowledge, authorization, or consent. The findings also stated that Kaye failed to respond to NASD requests for information. **(NASD Case #C04020030)**

**Kevin James Kowalski (CRD #728382, Registered Principal, Hanover Park, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any principal or supervisory capacity. Without admitting or denying the allegations, Kowalski consented to the described sanction and to the entry of findings that he failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with applicable securities laws and regulations and applicable rules of NASD regarding:

- ♦ The procedures requiring the prior approval of the Designated Supervisory Employee (DSE) or branch manager before the sale of restricted stock before associated persons of the firm could open an account with other NASD members, and before registered representatives could direct customers to investment opportunities that were not sponsored by the firm; but the procedures designated an individual as DSE who was not functioning in that capacity, and did not identify the person who had responsibility for functioning in the capacity of DSE or branch manager, who in fact was Kowalski;
- ♦ The sale of restricted stock;
- ♦ Suitability of transactions;
- ♦ Transactions for or by associated persons; and
- ♦ Private securities transactions, in that the procedures failed to define what was meant by "directing customers" or "sponsored by the firm."

In addition, the findings stated that Kowalski failed to enforce the firm's written supervisory procedures regarding private securities transactions by permitting a registered representative to effect securities transactions off the books and records of his member firm. **(NASD Case #C8A030052)**

**Thomas Donald Krosschell (CRD #1010632, Registered Representative, Eden Prairie, Minnesota)** submitted an Offer of Settlement in which he was fined \$60,000, suspended from association with any NASD member in any capacity for 18 months, and barred from association with any NASD member as a principal or supervisor. Without admitting or denying the allegations, Krosschell consented to the described sanctions and to the entry of findings that he purchased shares of common stock of companies on the basis of material and nonpublic information that a company was negotiating a reverse merger with another corporation and tipped others to purchase stock. The findings also stated that after the company publicly announced that it was negotiating a merger, the price of the stock increased significantly, and shortly thereafter Krosschell sold his stock from his member firm account and realized a profit. The findings further stated that Krosschell, for his direct or indirect personal benefit or as a gift, knowingly breached a fiduciary or similar duty of trust and confidence to the company and/or his member firm by disclosing, directly or indirectly to others, material nonpublic information regarding merger discussions between two companies.

Krosschell's suspension began August 4, 2003, and will conclude at the close of business February 3, 2005. (NASD Case #CMS020143)

**Luann Laney (CRD #1261793, Registered Principal, Arlington, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$7,500 and suspended from association with any NASD member in a principal or supervisory capacity for 30 business days. Without admitting or denying the allegations, Laney consented to the described sanctions and to the entry of findings that, while conducting a branch office audit of one of her firm's offsite registered representatives, she failed to review the branch office's checking account despite the fact that she was using an office examination checklist that contained specific inquiries about the branch office checking account which would have revealed a \$2.6 million fraudulent Ponzi scheme by a registered representative. The findings also stated that Laney allowed a representative to "voluntarily" resign without disclosing that the representative was under investigation for possible selling away, misappropriation of customer funds, and acting as a clearing firm.

Laney's suspension began July 21, 2003, and will conclude at the close of business August 29, 2003. (NASD Case #C06030012)

**Michael Allen Loween (CRD #2181503, Registered Representative, Washington)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Loween consented to the described sanction and to the entry of findings that he

participated in outside business activities without providing prompt written notice to his member firm. The findings also stated that Loween engaged in private securities transactions without prior written notice to, and approval from, his member firm. (NASD Case #C3B030009)

**Jeffrey Anthony Malfetti (CRD #2451948, Registered Representative, Warren, New Jersey)** 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 31 days. Without admitting or denying the allegations, Malfetti consented to the described sanctions and to the entry of findings that he was a trader responsible for executing his member firm's transactions in a common stock. The findings also stated that Malfetti, acting on behalf of his member firm, received two market-on-open orders to sell 70,900 shares of common stock and one market-on-open order to buy 4,791 shares, resulting in a sell imbalance of 66,109 shares to be executed at the opening price. The findings also stated that, prior to the market open, his member firm received a SelectNet order to buy 3,000 shares of common stock at \$15.12 per share, a price below his member firm's then current offer of \$15.35 per share. In addition, Malfetti, on behalf of his member firm, partially executed 100 shares of the pending SelectNet order at which time his member firm's published offer of \$15.26 per share represented the inside offer. The trade was reported to ACT and was the first unmodified trade at or after the open during normal business hours, thereby constituting the opening price. NASD found that the partial execution at an inferior price to his member firm's quote caused the opening price of common stock to be artificially reduced. Furthermore, the findings stated that Malfetti executed its market-on-open orders to sell 6,800 shares and 64,100 shares at \$15.12 per share and its market-on-open order to buy 4,791 shares at \$15.12 per share.

Malfetti's suspension began July 21, 2003, and will conclude at the close of business August 20, 2003. (NASD Case #CMS030132)

**Edward Atwood Maxfield (CRD #323631, Registered Principal, Desert Hot Springs, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$15,000, ordered to pay \$55,382 in financial benefits received to customers, and suspended from association with any NASD member in any capacity for one year. The fine must be paid and proof of payment of financial benefits must be made before Maxfield reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Maxfield consented to the described sanctions and to the entry of finding that he offered for sale and sold to public customers securities that were neither registered pursuant to Section 5 of the Securities Act of 1933 nor exempt from registration thereunder. The findings also stated that Maxfield permitted

persons who were not registered with his member firm to offer and sell these securities to public customers, and failed to obtain information required by NASD Rule 3110 with respect to certain purchasers of securities.

Maxfield's suspension began July 21, 2003, and will conclude at the close of business July 20, 2004. (NASD Case #C3A030023)

**Robert Edwin McBride (CRD #1195514, Registered Principal, Lakeside, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any principal or supervisory capacity. Without admitting or denying the allegations, McBride consented to the described sanction and to the entry of findings that he failed to establish, maintain, and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules regarding:

- ♦ The procedures requiring the prior approval of the Designated Supervisory Employee (DSE) or branch manager before the sale of restricted stock, before associated persons of his firm could open an account with other NASD members, and before registered representatives could direct customers to investment opportunities that were not sponsored by his firm, but the procedures designated an individual as DSE who was not functioning in that capacity, and did not identify the person who had responsibility for functioning in the capacity of DSE or branch manager;
- ♦ The sale of restricted stock, in that McBride knew or should have known that a registered representative was participating in the sale of restricted stock without the prior approval of any supervisory principal at his firm;
- ♦ Transactions for or by associated persons, in that McBride knew, or should have known, that his firm's registered representatives had opened accounts at other NASD member firms without first obtaining the prior written approval of any supervisory principal at his firm; and
- ♦ Private securities transactions, in that the procedures failed to define what was meant by "directing customers" or "sponsored by the firm," and the supervisory system was such that McBride knew, or should have known, that his firm's representatives were in fact directing customers to investment opportunities that were not sponsored by the firm and participating in private securities transactions without the prior written approval of any supervisory principal at his firm.

In addition, the findings stated that McBride failed to enforce his firm's written supervisory procedures regarding private securities transactions by permitting a registered representative to effect securities transactions off the books and records of the firm. (NASD Case #C8A030051)

**Padraig Conrad McGlynn (CRD #2983783, Registered Representative, Maspeth, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that McGlynn sent false documents to a public customer in that he signed and forwarded to the customer a letter with an enclosed document that McGlynn's letter described as a "Temporary Confirmation." NASD found that prior to sending the letter, McGlynn used a computer to create what appeared to be a letterhead for a company unrelated to his member firm and which was not associated with NASD, and used this letterhead on the letter and the Temporary Confirmation. In addition, the findings stated that the Temporary Confirmation falsely represented that the customer had agreed to purchase shares of stock and that shares had been purchased for the customer through his member firm when in fact the customer had not agreed to such a purchase, McGlynn had not placed an order to purchase the shares for the customer, and no such transactions had taken place. (NASD Case #C8A030014)

**Thomasina Michalik (CRD #1527578, Registered Representative, Farmingdale, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for 20 business days. Without admitting or denying the allegations, Michalik consented to the described sanctions and to the entry of findings that she participated in private securities transactions without providing her member firm with written notification.

Michalik's suspension began August 4, 2003, and will conclude at the close of business August 29, 2003. (NASD Case #CLI030015)

**Wade Robert Olsen (CRD #4527093, Associated Person, Eagan, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for one month. The fine must be paid before Olsen reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Olsen consented to the described sanctions and to the entry of findings that he failed to disclose material facts on his Form U4.

Olsen's suspension began August 4, 2003, and will conclude at the close of business September 3, 2003. (NASD Case #C04030035)

**John Douglas Parsons (CRD #2038288, Registered Representative, Madisonville, Louisiana)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Parsons requested and obtained from his member firm checks totaling \$893,700 to withdraw funds from the accounts of public customers without their knowledge or consent, endorsed the checks, and deposited them in a bank account he controlled thereby converting the

funds to his own use and benefit. NASD also found that Parsons failed to respond to NASD requests for information. (NASD Case #C05030005)

**Richard Armand Patenaude (CRD# 4069526, Registered Representative, Fort Washington, Maryland)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, ordered to disgorge commissions of \$23,312.15 and pay that amount as restitution to a public customer, and suspended from association with any NASD member in any capacity for two years. The fine and restitution must be paid before Patenaude reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Patenaude consented to the described sanctions and to the entry of finding that he signed a customer's name on an insurance company variable annuity application he completed without the customer's knowledge or authorization. The findings also stated that Patenaude did not notify anyone at his member firm that he had signed the customer's name on the application. NASD also found that Patenaude thereupon, without the customer's knowledge or authorization, submitted the application to the insurance company, causing a variable annuity to be purchased with funds that were in the customer's account at his member firm.

Patenaude's suspension began August 4, 2003, and will conclude at the close of business August 3, 2005. (NASD Case #C9A030022)

**David Lee Pearlman (CRD #1561050, Registered Representative, Hawthorne Woods, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Pearlman reassociates with a member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Pearlman consented to the described sanctions and to the entry of findings that he failed to give prior written notice of his intention to engage in private securities transactions to his member firm, and failed to receive written approval from his firm prior to engaging in such activities.

Pearlman's suspension began July 21, 2003, and will conclude at the close of business January 20, 2004. (NASD Case #C8A030050)

**Keith Edward Pelatowski (CRD #3129223, Registered Representative, East Haven, Connecticut)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member firm in any capacity. Without admitting or denying the allegations, Pelatowski consented to the described sanctions and to the entry of findings that he signed customer names to various forms

without authorization. The findings also stated that Pelatowski failed to respond to NASD requests for information. (NASD Case #C11030021)

**Jeffrey Scott Piek (CRD #3207495, Registered Representative, Loveland, Ohio)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Piek forged the names of existing public customers to financial advisory service agreements without the customers' knowledge or consent. The findings also stated that Piek forged the signatures of public customers to Mutual Fund and Certificate Redemption, Exchange and/or Transfer forms to withdraw \$500 from each account to pay the financial planning fee due under the forged financial planning agreements, and then withdrew \$500 from each account without the customers' knowledge or consent. (NASD Case #C8B030003)

**Joseph John Piscopo (CRD #2221826, Registered Representative, Staten Island, New York) and Peter Laurella (CRD #2386054, Registered Representative, Staten Island, New York)** were barred from association with any NASD member in any capacity. The sanctions were based on findings that they knowingly and deceptively devised and participated in a scheme whereby they caused the purchase of securities in the accounts of public customers without the knowledge, authorization, or consent of the customers, together receiving discretionary bonus payments of approximately \$60,000 based in part on the unauthorized trades. The findings also stated that Piscopo and Laurella failed to respond to NASD requests to appear for on-the-record interviews. (NASD Case #CAF020065)

**Jeffrey Allen Richardson (CRD #736249, Registered Principal, Columbus, Ohio)** 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, Richardson consented to the described sanction and to the entry of findings that he willfully participated in and facilitated an unlawful, unregistered sale of shares of stock from company accounts at his member firm to customers of another member firm through means of interstate commerce, generating profits for his member firm. NASD found that Richardson wired funds from the company accounts directly to a New York bank account in the name of the stock at the instruction of a company contact. The findings also stated that Richardson failed to conduct any inquiry as to the sources of the shares deposited into the accounts. If he had done so, he would have discovered that individuals were acting as underwriters or control persons in an unregistered distribution of shares of stock on behalf of the issuer. (NASD Case #CMS030156)

**Albert Lee Rosebush (CRD #1213100, Registered Representative, Mishawaka, Indiana)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member firm in any capacity for six weeks. Without admitting or denying the

allegations, Rosebush consented to the described sanctions and to the entry of findings that he failed and neglected to provide prompt written notice to his member firm of his outside business activities, in that he accepted compensation from another company for the sales of equity indexed annuities to public customers.

Rosebush's suspension began August 4, 2003, and will conclude September 14, 2003. (NASD Case #C8A030053)

**George Michael Santangelo (CRD #1089021, Registered Principal, Greenwich, Connecticut) and Lawrence M. Hoes (CRD #1962908, Registered Principal, Mahwah, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which they were fined \$50,000, jointly and severally, and each suspended from association with any NASD member in any principal or supervisory capacity for four months. Without admitting or denying the allegations, Santangelo and Hoes consented to the described sanctions and to the entry of findings that they aided and abetted the preparation and filing of false and misleading FOCUS reports and books and records by their member firm by entering into agreements with another NASD member firm that enabled their member firm to falsely, or deceptively, report or reflect the other firm's net capital on their firm's FOCUS reports and other financial documents. The findings also stated that a member firm, acting through Santangelo and Hoes, conducted a securities business when its net capital declined below the minimum amount required by the Securities and Exchange Commission (SEC).

Santangelo's and Hoes' suspensions will begin September 2, 2003, and will conclude January 1, 2004. (NASD Case #C10030049)

**Michael Court Scanlon (CRD #412027, Registered Representative, Columbus, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Scanlon reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Scanlon consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from his member firm.

Scanlon's suspension began July 21, 2003, and will conclude at the close of business January 20, 2004. (NASD Case C8B030011)

**Edward Douglas Shanklin, Jr. (CRD #1852074, Registered Representative, New Orleans, Louisiana)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for eight weeks. In light of the financial status of Shanklin, no monetary sanctions have been imposed. Without admitting or

denying the allegations, Shanklin consented to the described sanction and to the entry of findings that he participated in private securities transactions without providing prior written notice to his member firm.

Shanklin's suspension began August 4, 2003, and will conclude at the close of business September 26, 2003. (NASD Case #C05030033)

**David Alan Shaw (CRD #3152054, Registered Representative, Sumner, Indiana)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member firm in any capacity for 30 days. Without admitting or denying the allegations, Shaw consented to the described sanctions and to the entry of findings that he affixed the signature of a public customer who maintained a personal and a corporate securities account with his member firm on a document that authorized the combination of all assets of the personal and corporate accounts into one of the accounts without the customer's knowledge or consent.

Shaw's suspension began August 18, 2003, and will conclude at the close of business September 16, 2003. (NASD Case #C8A030055)

**Samuel Sherr (CRD #2163899, Registered Principal, Brooklyn, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 40 days. Without admitting or denying the allegations, Sherr consented to the described sanctions and to the entry of findings that he failed to respond timely to NASD requests to appear for an on-the-record interview.

Sherr's suspension began August 4, 2003, and will conclude at the close of business September 12, 2003. (NASD Case #C10030044)

**James Edward Stewart (CRD #2325868, Registered Principal, Walnut Creek, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,035, including disgorgement of commissions of \$535, and suspended from association with any NASD member in any capacity for 10 business days. The fine must be paid before Stewart reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Stewart consented to the described sanctions and to the entry of findings that he informed public customers that he would guarantee them against any losses in their securities investments, which he put in writing, and he signed the guarantee.

Stewart's suspension will begin August 18, 2003, and will conclude at the close of business August 29, 2003. (NASD Case #C02030040)

**Scott Hitoshi Tominaga (CRD #2416724, Registered Principal, Gilbert, Arizona)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity and ordered to pay \$40,173.92, plus interest, in restitution. Restitution must be paid before Tominaga requests relief from any statutory disqualification. Without admitting or denying the allegations, Tominaga consented to the described sanction and to the entry of findings that he effected transactions in the accounts of public customers without their prior knowledge, authorization, or consent. The finding also stated that Tominaga, on behalf of his member firm, prepared and filed with NASD false and misleading FOCUS Reports. NASD also found that Tominaga failed to respond to an NASD request to appear for an on-the-record interview. **(NASD Case #C3A030020)**

**Joseph Anthony Watters (CRD #1001336, Registered Representative, Monroeville, Pennsylvania)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Watters consented to the described sanction and to the entry of findings that he participated in business activities outside the scope of his employment with his member firm, and did not provide his firm with notice of the activities or his acceptance of compensation. The findings also stated that Watters failed to respond to an NASD request to appear for testimony. **(NASD Case #C9A030005)**

**John Michael Yates (CRD #3053691, Registered Representative, Niles, Michigan)** 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. Without admitting or denying the allegations, Yates consented to the described sanctions and to the entry of findings that he failed and neglected to provide prompt written notice to his member firm of his outside business activities.

Yates' suspension began July 21, 2003, and concluded at the close of business August 1, 2003. **(NASD Case #C8A030048)**

**Michael Reed Zigler (CRD #1020776, Registered Principal, Andover, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in a principal or supervisory capacity for 20 business days. Without admitting or denying the allegations, Zigler consented to the described sanctions and to the entry of findings that he permitted a statutorily disqualified individual to be a non-registered person associated with his member firm in a branch office.

Zigler's suspension began July 7, 2003, and concluded at the close of business August 1, 2003. **(NASD Case #C04030038)**

## Individual Fined

**Craig Stephan Gutmann (CRD #3261809, Registered Representative, Riverwoods, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was censured and fined \$33,329.30, which includes the disgorgement of transaction profit of \$30,829.30. Without admitting or denying the allegations, Gutmann consented to the described sanctions and to the entry of findings that, in contravention of NASD Rule IM-2110-1, he purchased, or allowed to be purchased, shares of common stock for the securities account in his name at another member firm and shares for the securities account in the name of a company in which Gutmann had a beneficial interest, at the public offering price. NASD also found that Gutmann failed to notify his member firm in writing of his control and beneficial interest in an account at a company that was established at another member firm. The findings also stated that Gutmann failed to notify the other member firm of his association at his member firm with respect to the account of a company that Gutmann controlled and in which he had a beneficial interest. **(NASD Case #C8A030057)**

## 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 July 4, 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*.

**Mark Horace Love (CRD #1268245, Registered Representative, Scottsdale, Arizona)** was fined \$25,000 and suspended from association with any NASD member in any capacity for 30 business days. The NAC imposed the sanctions following the appeal of an OHO decision. The sanctions were based on findings that Love participated in private securities transactions without giving prior written notice to his member firm.

Love has appealed the action to the SEC, and the sanctions are not in effect pending consideration of the appeal. **(NASD Case #C3A010009)**

**Thomas Andrew Timberlake (CRD #870022, Registered Principal, Tampa, Florida)** was fined \$25,000, suspended from association with any NASD member in any capacity for two years, and ordered to offer rescission by purchasing, at the original purchase price, the Certificates of Deposit (CDs) he sold to, and which are still held by, public customers. Timberlake was also ordered to pay \$3,400 in restitution to public customers. The sanctions were based on findings that Timberlake made material misrepresentations and omissions of fact concerning the sale of callable CDs to public customers.

Timberlake has appealed this decision to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C07010099)

**J. Alexander Securities, Inc. (CRD #7809, Los Angeles, California) and James Alexander (CRD #2762, Registered Principal, Los Angeles, California).** The firm was fined \$200,000 and required to hire an independent consultant for three years to review its supervisory, compliance, and other policies and procedures designed to detect and prevent federal securities and NASD rules violations. In addition, the firm's market-making functions in a branch were suspended for 60 days or until the recommendations of the independent consultant are implemented, whichever is later. Alexander was fined \$200,000, suspended from association with any NASD member in any capacity for two years, and ordered to requalify by exam as a principal. The suspension as a principal will continue until he has requalified as a principal by exam. The sanctions against the firm and Alexander were based on findings that the firm and Alexander failed to establish and maintain an adequate supervisory system to detect and deter the misconduct of a registered representative.

The firm and Alexander appealed the findings and sanctions, and the Department of Enforcement cross-appealed as to the sanctions. The sanctions are not in effect pending consideration of the appeal by NASD's NAC. (NASD Case #CAF010021)

## 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.

**Jonathan B. Abrams (CRD #2052573, Registered Principal, River Edge, New Jersey)** was named as a respondent in an NASD complaint alleging that he failed and neglected to insure that municipal securities transactions executed by his member firm were executed at prices that were fair and reasonable. The complaint also alleged that Abrams failed and neglected to establish, maintain, and enforce his member firm's written supervisory procedures, which would insure that municipal security sales prices were fair and reasonable in accordance with MSRB Rule G-30. (NASD Case #C9B030043)

**John Steven Blount (CRD #2253398, Registered Representative, Lake Charles, Louisiana)** was named as a respondent in an NASD complaint alleging that he made recommendations for public customers that were unsuitable in view of the customers' investment objectives, income, low risk tolerance, need for liquidity and income, and interest in preserving principal. The complaint also alleges that Blount knowingly and recklessly misrepresented material features of the contracts to fraudulently induce the customers' purchases in that he provided the customers with written "proposals" that omitted material facts, contained unwarranted claims, and were misleading. The complaint further alleges that Blount directed his sales assistant to record inaccurately the customers' financial situation and investment objective information on a section of the annuity application designated as the "Client Profile" form, which is used by Blount's firm to review the suitability of investment recommendations and sales. In addition, the complaint alleges that Blount participated in a private securities transaction without providing prior written notice to his member firm. (NASD Case #C05030034)

**Larry Joseph Bolden (CRD #2073064, Registered Representative, Austin, Texas)** was named as a respondent in an NASD complaint alleging that he signed the name of a public customer to letters of authorization, thereby causing the transfer of \$23,466 from the customer's account to accounts under his control without the customer's authorization, knowledge, or consent. The complaint also alleges that Bolden directed that \$23,466 of a customer's funds be transferred to account(s) he controlled and used the funds for his own benefit without the customer's authorization, knowledge, or consent. In addition, the complaint alleges that Bolden failed to respond to NASD requests for information. (NASD Case #C06030010)

**Mario Lucas Chavez (CRD #4082977, Registered Representative, Albuquerque, New Mexico)** was named as a respondent in an NASD complaint alleging that he received \$22,103.24 from a public customer intended for investment. The complaint alleges that Chavez delivered the \$16,053.24 check to his member firm, directed the office staff to apply \$11,000 to the purchase of a fixed annuity and to issue a \$5,053.24 check payable to his member firm's clearing firm, and took possession of the check payable to the clearing firm and deposited it into a securities account in his name with his member firm. Furthermore, the complaint alleges that Chavez failed to invest the proceeds of the check payable to the clearing firm and the cash he received from the customer for the customer's benefit, and, instead, retained possession of these funds and used them for his own personal use and benefit. In addition, the complaint alleges that Chavez prepared an account statement, or caused it to be prepared, and delivered it to the customer in order to conceal from the customer that he had taken the funds and used them for his personal benefit. The complaint also alleges that Chavez failed to respond to NASD requests for information. (NASD Case #C3A030025)

Patrick Troy Fanning (CRD #4051410, Registered Representative, Mechanicsville, Maryland) was named as a respondent in an NASD complaint alleging that he withdrew at least \$22,380 from the accounts of public customers for his own use and benefit. The complaint also alleges that Fanning withdrew \$22,292.96 from the accounts of public customers without their knowledge, authorization, or consent, and deposited the funds into the accounts of the customers from which he had withdrawn \$22,380, thereby misusing customer funds. In addition, the complaint alleges that Fanning failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C10030045)

Robert Cowan Hess (CRD #2871722, Registered Representative, South Amboy, New Jersey) and Russell Wayne Miller (CRD #3219969, Registered Representative, Cibold, Texas) were named as respondents in an NASD complaint alleging that they recommended purchase and sale transactions in various securities to a public customer without having reasonable grounds for believing that such transactions were suitable for the customer in light of the size of the transactions, the customer's financial situation, investment objectives, needs, and/or the nature of the securities. (NASD Case #C9B030041)

Anthony Koulouris (CRD #3011289, Registered Representative, Carle Place, New York) was named as a respondent in an NASD complaint alleging that he effected, or caused to be effected, a transaction in the account of a public customer without the customer's knowledge, authorization, or consent. The complaint also alleges that Koulouris failed to testify truthfully during an NASD on-the-record interview and failed to respond to NASD requests for information. In addition, the complaint alleges that Koulouris failed to disclose material information on his Form U4. (NASD Case #C10030042)

George Arthur Murphy, Jr. (CRD #1036919, Registered Principal, Havertown, Pennsylvania) was named as a respondent in an NASD complaint alleging that in connection with the purchase or sale of securities, he knowingly or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive or other fraudulent devices or contrivances. The complaint also alleges that Murphy engaged in the short-term purchase and sale of securities in accounts of public customers and did not have a reasonable basis for believing that such transactions were suitable for the customers based upon the frequency of the transactions, the nature of their accounts, and their financial situation, and needs. In addition the complaint alleges that Murphy exercised discretion in the accounts of public customers without having obtained prior written authorization from the customers and prior written acceptance of these accounts as discretionary by his member firm. (NASD Case #C9A030023)

Morgan Wilshire Securities, Inc. (CRD #44807, Westbury, New York) and Barry Francis Cassese (CRD #2080657, Registered Principal, E. Northport, New York) were named as respondents in an NASD complaint alleging that the firm, acting through Cassese and other representatives, effected transactions in highly liquid securities as either principal or agent and charged excessive markups, markdowns, and commissions. The complaint also alleges that the firm and Cassese failed to maintain and enforce a supervisory system with regard to charges to customers that was reasonably designed to achieve compliance with NASD rules to prevent charging customers excessive amounts for transactions. (NASD Case #CAF030030)

### **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.)

**Carrasquillo, Marcus**  
Oceanside, New York  
(June 19, 2003)

**Cope, Anthony D.**  
Coraopolis, Pennsylvania  
(June 9, 2003)

**Figat, Brian Christopher**  
East Patchogue, New York  
(June 19, 2003)

**Mason, Gregory A.**  
New York, New York  
(June 10, 2003)

**Reese, Daniel B.**  
Cleburne, Texas  
(June 13, 2003)

**Schwartz, Robert A.**  
Los Angeles, California  
(June 9, 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.)

**Gentry, Joshua A.**  
Kyle, Texas  
(June 27, 2003)

Langley, Robert J.  
Laguna Beach  
California (June 24, 2003)

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

Strasser, Michael  
Woodcliff Lake, New Jersey  
(June 19, 2003)

### **NASD Charges Sisung Securities with Wrongfully Receiving Over \$2 Million in Underwriting Fees in 21 Municipal Bond Offerings**

NASD has charged Sisung Securities Corp. of New Orleans, La., and its owner, Lawrence J. Sisung, Jr., with violating securities rules by participating in 21 municipal bond offerings in which the firm was not eligible to participate due to political contributions to members of the Louisiana State Bond Commission.

The NASD complaint alleges that from 1998 through 2001, Sisung made 14 political contributions, through entities that he controlled, of almost \$17,000 to members of the Louisiana State Bond Commission. MSRB (Municipal Securities Rulemaking Board) Rule G-37 prohibited Sisung's brokerage firm from participating in any municipal business approved by the Louisiana State Bond Commission for two years from the date of each contribution. However, Sisung Securities failed to follow this restriction and improperly participated in 21 Louisiana bond issues, earning more than \$2.1 million in municipal underwriting fees.

In addition, NASD charged that Sisung Securities failed to report political contributions of over \$44,000, which includes the \$17,000, as required by MSRB rules, and failed to keep required records of such contributions.

The MSRB is the self-regulatory organization charged with primary rulemaking authority for the municipal securities activities of brokers and dealers. NASD enforces the rules of the Municipal Securities Rulemaking Board.

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 Brings Enforcement Action For Class B Mutual Fund Share Sales Abuses And Issues Investor Alert on Class B Shares**

NASD has censured and fined McLaughlin, Piven, Vogel Securities, Inc. (MPV) and its Chairman a total of \$100,000 for supervisory violations and unsuitable sales of Class B shares of mutual funds, and directed restitution of approximately \$90,000 to customers. Additionally, NASD suspended MPV's Chairman James C. McLaughlin for a period of 30 business days in his capacity as a principal.

Today's action is part of a larger, ongoing focus of NASD on the sale of Class B mutual fund shares. In the last two years NASD has brought more than half a dozen significant enforcement cases involving sales violations of Class B shares.

NASD has also released an alert to investors about the expenses involved in purchasing Class B mutual fund shares and how to determine which share class may be appropriate. The alert, Class B Mutual Fund Shares: Do They Make the Grade? can be found at [www.nasdr.com/alert\\_classb\\_funds.htm](http://www.nasdr.com/alert_classb_funds.htm). The alert also includes an expense analyzer that allows comparisons between two funds or classes of funds at one time, tells investors where the fees fall compared to industry averages, and highlights when investors should look for breakpoint discounts. Using NASD's Mutual Fund Expense Analyzer, investors can calculate and compare the expenses of Class A, B, or C shares or any other shares class offered.

"Today's enforcement action puts brokers on notice that investors must be sold an appropriate class of mutual fund, and our Investor Alert gives investors the tools to educate themselves about the costs involved when purchasing Class B shares," said Mary L. Schapiro, NASD Vice Chairman and President of Regulatory Policy and Oversight. "The information in today's alert allows investors to better protect themselves when purchasing mutual funds."

In the enforcement action, NASD found that from June 1998 through May 2002, MPV violated NASD's suitability rules by recommending purchases of large volumes of Class B shares of mutual funds in the accounts of 21 MPV customers totaling approximately \$9.3 million. The large purchases of Class B shares deprived customers of the lower or potentially lower sales charges available through Class A shares of the same funds.

While Class A shares typically involve a front-end sales charge, these fund shares also typically incur lower ongoing charges and there is no contingent deferred sales charge upon the sale of the shares. Class B mutual fund shares generally do not incur a front-end sales charge, but generally are subject to higher ongoing charges and a contingent deferred sales charge upon the sale of shares.

In one instance, a broker recommended the purchase of Class B shares of mutual funds in four different fund families for a single customer's account in lieu of the less costly Class A shares. The positions accumulated in these shares in each of the fund families ranged from \$375,000 to \$650,000.

NASD also found that MPV and its Chairman and supervisory principal, James C. McLaughlin, failed to establish, maintain, and enforce an adequate supervisory system that would have detected and prevented the unsuitable large Class B share positions.

In settling this matter, MPV and McLaughlin neither admitted nor denied the allegations, but consented to the entry of findings. MPV also agreed to hire an independent consultant to review and recommend revisions to its supervisory system in connection with its investment company securities business.

## 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? ([http://www.nasd.com/Investor/Alerts/alert\\_classb\\_funds.htm](http://www.nasd.com/Investor/Alerts/alert_classb_funds.htm)).

"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.

**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.

**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.

**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.

**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.

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.