



Notices to Members

Notices

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Notice to Members

FEBRUARY 2003

SUGGESTED ROUTING

Legal/Compliance
Retail
Senior Management

INFORMATIONAL

NASD Reminds Members of Obligations When Selling Hedge Funds

KEY TOPICS

Hedge Funds
Funds of Hedge Funds
Suitability
Due Diligence
Internal Controls
Supervision
Training

Executive Summary

As a result of a recent review of members that sell hedge funds and registered products (closed-end funds) that invest in hedge funds ("funds of hedge funds"), NASD staff is concerned that members may not be fulfilling their sales practice obligations when selling these instruments, especially to retail customers. In issuing this *Notice to Members*, NASD reminds members of their obligations when selling hedge funds and funds of hedge funds, including: (1) providing balanced disclosure in promotional efforts; (2) performing a reasonable-basis suitability determination; (3) performing a customer-specific suitability determination; (4) supervising associated persons selling hedge funds and funds of hedge funds; and (5) training associated persons regarding the features, risks, and suitability of hedge funds.

Questions/Further Information

Questions regarding this *Notice* may be directed to Daniel Sibears, Senior Vice President and Deputy, Member Regulation, NASD Regulatory Policy and Oversight, at (202) 728-6911, or Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, NASD Regulatory Policy and Oversight, at (202) 728-8104.

03-07

Discussion

Background

With the recent surge in the popularity of hedge funds, NASD is concerned about the sales practices of certain members selling direct interests in hedge funds and indirect interests through funds of hedge funds.¹ This *Notice to Members* highlights members' obligations when recommending hedge funds and funds of hedge funds to retail investors.²

Most investment funds constitute "investment companies" under the Investment Company Act of 1940 ("IC Act") and are registered with the Securities and Exchange Commission (SEC). The registration of investment companies provides investors in the fund with a panoply of disclosures and protections, including regulations that, among other things: (1) require a certain degree of liquidity; (2) limit how much can be invested in any one investment; (3) require that fund shares be redeemable; (4) protect against conflicts of interests; (5) assure fairness in the pricing of the fund shares; (6) require disclosure of information about a fund's management, holdings, fees and expenses, and performance; and (7) limit the use of leverage.

In addition, registered investment companies generally conduct public offerings of securities that are registered with the SEC under the Securities Act of 1933 (the "'33 Act"). This registration of the securities under the '33 Act provides further investor protection by virtue of the disclosure requirements that pertain to the characteristics and risks of the securities being offered.

By contrast, most hedge funds are investment companies that are not

registered pursuant to certain exemptions under the IC Act. Furthermore, the securities offered by hedge funds, in most cases, are exempt from registration under the '33 Act. Typically, hedge fund offerings are conducted as private placements under Regulation D under the '33 Act. Because neither the hedge fund nor the securities offered are registered, the range of protections attendant to such registrations are not provided; consequently, such securities may only be offered privately to certain qualified investors who meet the financial standards promulgated in the exemptions of the investment company and the securities from registration.

By comparison, certain funds of hedge funds are registered with the SEC under the IC Act and offerings of their securities registered under the '33 Act. Nevertheless, since the underlying investments are in unregistered hedge funds, these funds of hedge funds pose many of the same risks to investors.³ This presents a particular concern because registered funds of hedge funds may be offered to investors meeting far lower financial thresholds than those investors eligible to invest directly in the underlying unregistered hedge fund. In addition, the minimum investment levels for registered funds are significantly lower than that for unregistered hedge funds, sometimes as low as \$25,000. (Unregistered hedge funds generally have had investment minimums of \$1,000,000.)

There are wide differences between the fees associated with investments in registered hedge funds and those in unregistered hedge funds. Managers of unregistered hedge funds may receive both a management fee, which is a fee based on the percentage of assets under management, and a carried interest,

which is a direct percentage interest in the profits earned. The total of these fees is significantly more than those normally associated with the securities offered by registered investment companies.

Beyond the distinctions between registered and unregistered hedge funds, NASD is concerned about the offering of hedge funds as an asset class to retail investors. Specifically, NASD believes that members should take into account the fact that hedge fund investing historically has been available only to high net worth individual investors and institutions and consider whether the fact that certain hedge funds are now available to a broader segment of investors may itself be a red flag that casts doubt on the desirability and suitability of such funds for retail investors.

NASD's review revealed that some members may not be fulfilling their sales practice obligations when selling hedge funds (or funds of hedge funds). Furthermore, NASD also is concerned that customers may not fully understand the risks associated with hedge funds. In particular, NASD would like to remind members of their obligations concerning the sale of hedge funds in the five following areas: (1) Promotion of Hedge Funds; (2) Reasonable-Basis Suitability; (3) Customer-Specific Suitability; (4) Internal Controls; and (5) Training.

Promotion of Hedge Funds

Sales material and oral presentations that promote hedge funds (or funds of hedge funds) raise particular investor protection concerns. NASD reminds its members that the promotion of hedge funds must be balanced by a fair presentation of the risks and potential disadvantages of hedge fund investing.

For example, members may not claim that hedge funds offer superior professional management with more investment flexibility, protection against declining markets, and better returns due to the imposition of performance fees (e.g., fees charged by the hedge fund adviser based on the fund's investment performance), unless these statements are fair, accurate, and without exaggeration. In addition, members must balance sales material or oral presentations that promote the advantages of hedge fund investing with full disclosure of the risks that hedge funds present, including, as applicable, the fact that hedge funds (or funds of hedge funds):

- ◆ Often engage in leveraging and other speculative investment practices that may increase the risk of investment loss;
- ◆ Can be highly illiquid;
- ◆ Are not required to provide periodic pricing or valuation information to investors;
- ◆ May involve complex tax structures and delays in distributing important tax information;
- ◆ Are not subject to the same regulatory requirements as mutual funds; and
- ◆ Often charge high fees.

Members also must provide investors with any prospectus or other disclosure document of the hedge fund (or fund of hedge funds). Members should bear in mind, however, that providing a prospectus does not satisfy the duty to provide balanced sales materials and oral presentations.

Reasonable-Basis Suitability

Under reasonable-basis suitability, a member that recommends hedge funds, directly or indirectly, must have a belief that the product is suitable for any investor. Members discharge this requirement by conducting due diligence with respect to the hedge fund, or in the case of a fund of hedge funds, with respect to the underlying hedge funds. Due diligence is especially important for hedge funds because, as noted above, many hedge funds are not registered as investment companies and are offered through unregistered private placements. Members therefore have a heightened responsibility to investigate the hedge funds and funds of hedge funds that they recommend to customers. Members must perform substantial due diligence into a hedge fund before making any recommendation to a customer, including, but not limited to: an investigation of the background of the hedge fund manager, reviewing the offering memorandum, reviewing the subscription agreements, examining references, and examining the relative performance of the fund. Finally, NASD is concerned about the offering of hedge funds as an asset class to retail investors. Specifically, NASD believes that members should take into account the fact that hedge fund investing historically has been available only to high net worth individual investors and institutions and consider whether the fact that certain hedge funds are now available to a broader segment of investors may itself be a red flag that casts doubt on the desirability and suitability of such funds for retail investors.

Customer-Specific Suitability

To satisfy the requirement of customer-specific suitability, a member must determine that its recommendation³ to invest in a hedge fund or a fund of hedge funds is suitable for that particular investor.⁴ Under NASD Rule 2310, members must ensure that a recommendation is suitable for a specific customer by examining (1) the customer's financial status, (2) the customer's tax status, (3) the customer's investment objectives, and (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer. NASD's review of members revealed that some firms rely heavily on an investor's status as an accredited investor under Regulation D of the '33 Act as the single criterion for satisfying their suitability obligations in connection with the sale of hedge funds. A customer's specific level of assets does not, by itself, satisfy a member's obligations under the suitability rule.⁵ Members and their associated persons must examine the factors listed in NASD Rule 2310 prior to making any recommendation.

Internal Controls

A member's internal controls, including supervision and compliance, must ensure that sales of hedge funds and funds of hedge funds comply with all relevant NASD and SEC rules. Members must include written procedures for supervisory personnel to review compliance with NASD and SEC rules, the accuracy of information gathered, and the appropriateness of the suitability determinations made by their associated persons. Beyond establishing written

supervisory procedures, members also must be able to demonstrate adherence to such procedures.

Training

Members must train associated persons about the characteristics of and risks associated with hedge funds before they allow associated persons to recommend hedge funds or funds of hedge funds. Educational pamphlets, videos, intranet systems, in-person lectures, and explanatory memos are all appropriate vehicles for training. The training may vary based on the type of firm and the firm's size, customer base, and resources. NASD urges any member that sells hedge funds to include hedge funds as part of the Firm Element of their Continuing Education Program.

Conclusion

Hedge funds are complex investment vehicles, which are often risky and lacking in transparency. Consequently, many investors, especially retail investors, may not understand the risks associated with investing in hedge funds and funds of hedge funds. Given these considerations and the fact that certain hedge funds are for the first time being offered to a broader investor segment, NASD considers it essential that members reach an initial determination about the suitability of such funds to any retail investors before performing an individual suitability assessment. Members also must ensure that any promotional efforts of hedge funds or funds of hedge funds are fair and balanced. Finally, members must properly supervise and train all associated persons selling these products to ensure that associated persons comply with applicable securities laws.

Endnotes

- 1 For purposes of this *Notice to Members*, a hedge fund can be described as a private and unregistered investment pool that accepts investors' money and employs sophisticated hedging and arbitrage techniques using long and short positions, leverage and derivatives, and investments in many markets. Hedge funds vary in size and trading strategies, including categories such as: relative value hedge funds, event driven hedge funds, equity hedge funds, global asset allocator hedge funds, short selling hedge funds, sectoral hedge funds, and market neutral hedge funds.
- 2 See also NASD Investor Alert, Funds Of Hedge Funds - Higher Costs And Risks For Higher Potential Returns (Aug 23, 2002) at http://www.nasdr.com/alert_hedgefunds.htm
- 3 While funds of hedge funds offer a greater degree of diversification, they still present the same concerns as investments in hedge funds directly.
- 4 Acting as a placement agent may still bring a member within the term "recommendation." NASD has previously stated, "In particular, a transaction will be considered to be recommended when the member or its associated person brings a specific security to the attention of a customer through any means, including, but not limited to, direct telephone communication, the delivery of promotional material through the mail, or the transmission of electronic materials." *Notice to Members 96-60* (Sept. 1996). Bringing a specific hedge fund to the attention of a customer therefore may constitute a recommendation.
- 5 NASD's suitability rule states that in recommending to a customer the purchase, sale, or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer. As the rule states, a member's suitability obligation applies to securities that the member "recommends" to a customer. See *Notice to Members 01-23* (Apr. 2001).

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- 6 See *Patrick G. Keel*, 51 S.E.C. 282, 286 n.14 (1993) (“[E]vidence of wealth, as we have stated previously, is not an indicator of suitability.”); *Arthur J. Lewis*, 50 S.E.C. 747, 749 (1991) (“The fact that a customer . . . may be wealthy does not provide a basis for recommending risky investments”)

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Notice to Members

FEBRUARY 2003

SUGGESTED ROUTING

Legal & Compliance
Operations

KEY TOPICS

Rule 3360
Short Interest Reporting
Short Sales

INFORMATIONAL

Short Interest Reporting

NASD Clarifies the Application of Short Interest Reporting Rule

Executive Summary

On January 10, 2003, the Securities and Exchange Commission (SEC) issued an order announcing the immediate effectiveness of amendments to NASD Rule 3360 (Rule 3360 or the Rule) that clarify that short sale positions held by members for other broker/dealers must be reported under Rule 3360(a), unless these positions already are reported to a self-regulatory organization (SRO).¹ Attachment A contains the text of the amendments.

Questions/Further Information

Questions regarding this *Notice* may be directed to the NASD Office of General Counsel, Regulatory Policy and Oversight, at 202-728-8071, or Jocelyn Rena, Market Regulation Department, at 240-386-5091.

Background And Discussion

NASD Rule 3360(a) requires members to maintain a record of total short positions in all customer and proprietary firm accounts in NASDAQ securities (and listed securities if not reported to another SRO) and requires members to report such information to NASD on a monthly basis. Rule 3360(b) provides that short positions required to be reported under the Rule are those resulting from short sales as the term is defined in Rule 3b-3 under the Securities Exchange Act of 1934 (Exchange Act),² with limited exceptions.

03-08

NASD staff has received inquiries from members concerning the application of Rule 3360 in light of the definition of "customer" in NASD Rule 0120(g). Specifically, Rule 0120(g) provides that the term "customer" does not include a broker or dealer, unless the context otherwise provides. As a result, members have inquired whether short sale positions of accounts held for other broker/dealers are required to be reported under Rule 3360.

In response to such inquiries, the staff has advised members that short sale positions held for other broker/dealers that fall within the definition of short position provided in Rule 3360(b) must be reported under Rule 3360(a), unless these positions already are reported to an SRO. This long-standing position is consistent with that taken by other SROs with respect to their short interest reporting requirements.³ Non-self-clearing broker/dealers generally are considered to have satisfied their reporting requirement by making appropriate arrangements with their respective clearing organizations. In addition, because non-member broker/dealers are not subject to NASD rules and, therefore, are not required to comply with Rule 3360, it is particularly important that members understand that they must report such positions under the Rule, unless these positions are otherwise reported to an SRO. Accordingly, to eliminate all ambiguity, NASD has amended Rule 3360(a) to clarify that short sale positions of accounts held for other broker/dealers must be reported, unless the position is otherwise reported to an SRO.

Endnotes

- 1 Exchange Act Release No. 47158 (January 10, 2003) (File No. SR-NASD-2002-178), 68 *Federal Register* 2382 (January 16, 2003).
- 2 Rule 3b-3 under the Exchange Act provides, in part, the following: "The term 'short sale' means any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller."
- 3 See Exchange Act Release No. 35287 (January 27, 1995), approving amendments to short interest reporting rules of NASD, New York Stock Exchange, Philadelphia Stock Exchange, Pacific Stock Exchange, Boston Stock Exchange, Chicago Stock Exchange, and Chicago Board Options Exchange, to ensure uniform short position reporting across each of the SROs.

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ATTACHMENT A

New language is underlined; deletions are in brackets.

3360. Short-Interest Reporting

(a) Each member shall maintain a record of total “short” positions in all customer and proprietary firm accounts in securities included in The Nasdaq Stock Market and in each other security listed on a registered national securities exchange and not otherwise reported to another self-regulatory organization and shall regularly report such information to [the Association] NASD in such a manner as may be prescribed by [the Association] NASD. For the purposes of this rule, the term “customer” includes a broker/dealer. Reports shall be made as of the close of the settlement date designated by [the Association] NASD. Reports shall be received by [the Association] NASD no later than the second business day after the reporting settlement date designated by [the Association] NASD.

(b) No change.

Notice to Members

FEBRUARY 2003

SUGGESTED ROUTING

Legal & Compliance
Operations
Registration
Senior Management

KEY TOPICS

District Elections

District Elections

NASD Announces Election Results for District Committees and District Nominating Committees

Executive Summary

Through this *Notice*, NASD announces the election results for the District Committees and the District Nominating Committees. The newly elected District Committee members will serve until 2006.

District 10 (New York) had an additional candidate come forward for consideration for that District Committee. Ballots were submitted and counted on January 10, 2003. The originally proposed slate of candidates for District 10 (New York) received the largest number of votes and is declared elected.

The members of the incoming District Committees and the District Nominating Committees are included in Attachment A.

Questions/Further Information

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

03-09

ATTACHMENT A

District Committee and District Nominating Committee 2003 Incoming Members

District 1

Elisabeth P. Owens, District Director

525 Market Street, Suite 300, San Francisco, CA 94105
(415) 882-1201

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

2003 District 1 Incoming Members

Steven R. Aaron	J.P. Morgan Securities (one-year term)	San Francisco, CA
Gerard P. Gloisten	GBS Financial Corporation (two-year term)	Santa Rosa, CA
Warren E. Gordon	Charles Schwab & Co., Inc.	San Francisco, CA
William P. Hayes	Wells Fargo Investments, LLC	San Francisco, CA
Francis X. Roche, II	RBC Dain Rauscher, Inc.	San Francisco, CA

2003 District 1 Nominating Committee Incoming Members

Sally G. Aelion	Emmett A. Larkin Company, Inc.	San Francisco, CA
John H. Chung	SVP Securities	Santa Clara, CA
Glenn M. Colacurci	Salomon Smith Barney	San Francisco, CA
James D. Klein	UBS PaineWebber, Inc.	San Francisco, CA
Jerry D. Phillips	RBC Dain Rauscher, Inc.	San Francisco, CA

District Committee and District Nominating Committee 2003 Incoming Members

District 2

Lani M. Sen Woltmann, District Director

300 South Grand Avenue, Suite 1600, Los Angeles, CA 90071
(213) 613-2601

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

2003 District 2 Incoming Members

A. William Cohen	Integrated Trading and Investments, Inc.	Las Vegas, NV
Don S. Dalis	USB PaineWebber Inc.	Newport Beach, CA
Donna Bartlett Lawson	First Allied Securities, Inc.	San Diego, CA

2003 District 2 Nominating Committee Incoming Members

Margaret M. Black	Morgan Stanley Dean Witter	Los Angeles, CA
George H. Casey	Crowell Weedon & Co.	Los Angeles, CA
Miles Z. Gordon	Financial Network Investment Corporation	Torrance, CA
Dean A. Holmes	Valic Financial Advisors, Inc.	Glendale, CA
Robert L. Winston	American Funds Distributors, Inc.	Los Angeles, CA

**District Committee and District Nominating Committee
2003 Incoming Members**

District 3

Joseph M. McCarthy, District Director

Republic Plaza Building, 370 17th Street, Suite 2900, Denver, CO 80202-5629
(303) 446-3100

Arizona, Colorado, New Mexico, Utah, and Wyoming

James G. Dawson, District Director

Two Union Square, 601 Union Street, Suite 1616, Seattle, WA 98101-2327
(206) 624-0790

Alaska, Idaho, Montana, Oregon, and Washington

2003 District 3 Incoming Members

Gene G. Branson	Partners Investment Network, Inc.	Spokane, WA
Bridget M. Gaughan	SunAmerica Financial Network, Inc.	Phoenix, AZ
John W. Goodwin	Goodwin Browning & Luna Securities, Inc.	Albuquerque, NM

2003 District 3 Nominating Committee Incoming Members

L. Hoyt DeMers	Wells Fargo Investments, LLC	Seattle, WA
J. David Griswold	Frank Russell Securities, Inc.	Tacoma, WA
Martin O. Nelson, Jr.	Martin Nelson & Co., Inc.	Seattle, WA
William G. Papesh	WM Funds Distributor, Inc.	Seattle, WA
Anthony B. Petrelli	Neidiger, Tucker, Bruner, Inc.	Denver, CO

**District Committee and District Nominating Committee
2003 Incoming Members**

District 4

Thomas D. Clough, District Director

120 W. 12th Street, Suite 900, Kansas City, MO 64105
(816) 802-4708

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

2003 District 4 Incoming Members

Deborah M. Castiglioni	Cutter & Company, Inc.	Chesterfield, MO
Terry L. Lister	Cambridge Investment Research, Inc.	Fairfield, IA
Richard J. Miller	Walnut Street Securities, Inc.	St. Louis, MO

2003 District 4 Nominating Committee Incoming Members

Norman Frager	Flagstone Securities, LLC	St. Louis, MO
E. John Moloney	Moloney Securities Co., Inc.	St. Louis, MO
Rodger O. Riney	Scottrade, Inc.	St. Louis, MO
Jeffrey A. Schuh	Wells Fargo Investment Services	Minneapolis, MN
Gail Werner-Robertson	GWR Investments, Inc.	Omaha, NE

**District Committee and District Nominating Committee
2003 Incoming Members**

District 5

Warren A. Butler, Jr., District Director

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

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

2003 District 5 Incoming Members

Victor E. Blaylock	BancorpSouth Investment Service, Inc.	Jackson, MS
Carolyn R. May	Benchmark Investments, Inc.	Arkadelphia, AR
F. Eugene Woodham	Sterne, Agee & Leach, Inc.	Birmingham, AL

2003 District 5 Nominating Committee Incoming Members

Carl W. Busch	Prudential Securities Incorporated	Edmond, OK
E. Douglas Johnson, Jr.	Johnson Rice & Company	New Orleans, LA
James M. Rogers	J.J.B. Hilliard, W.L. Lyons, Inc.	Louisville, KY
William L. Tedford, Jr.	Stephens Inc.	Little Rock, AR
Duncan F. Williams	Duncan-Williams, Inc.	Memphis, TN

**District Committee and District Nominating Committee
2003 Incoming Members**

District 6

Bernerd E. Young, District Director

12801 N. Central Expressway, Suite 1050, Dallas, TX 75243
(972) 701-8554

Texas

2003 District 6 Incoming Members

Brent T. Johnson	IFG Network Securities, Inc.	Houston, TX
John R. Muschalek	First Southwest Company	Dallas, TX
Robert L. Nash	SWS Securities, Inc.	Dallas, TX

2003 District 6 Nominating Committee Incoming Members

C. Ronald Baker	Williams Financial Group	Lubbock, TX
Robert A. Estrada	Estrada Hinojosa & Company, Inc.	Dallas, TX
Fredrick W. McGinnis	UBS PaineWebber, Inc.	Houston, TX
Edward M. Milkie	Milkie/Ferguson Investments, Inc.	Dallas, TX
Jim G. Rhodes	Rhodes Securities, Inc.	Fort Worth, TX

**District Committee and District Nominating Committee
2003 Incoming Members**

District 7

Alan M. Wolper, District Director

One Securities Centre, Suite 500, 3490 Piedmont Road, NE, Atlanta, GA 30305
(404) 239-6128

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

2003 District 7 Incoming Members

Joseph B. Gruber	FSC Securities Corporation	Atlanta, GA
Dennis S. Kaminski	Mutual Service Corporation	West Palm Beach, FL
James A. Klotz	First Miami Securities, Inc.	N. Miami Beach, FL

2003 District 7 Nominating Committee Incoming Members

Michael D. Hearn	Banc of America Investment Services, Inc.	Charlotte, NC
Edward R. Hipp, III	Legg Mason Wood Walker, Inc.	Williamsburg, VA
J. Lee Keiger, III	Davenport & Company LLC	Richmond, VA
John W. Waechter	William R. Hough & Co.	St. Petersburg, FL
Roark K. Young	Young, Stovall & Company	Miami, FL

**District Committee and District Nominating Committee
2003 Incoming Members**

District 8

Carlotta A. Romano, District Director

55 West Monroe Street, Suite 2700, Chicago, IL 60603
(312) 899-4324

Illinois, Indiana, Michigan, and Wisconsin

William H. Jackson, Jr., District Director

Renaissance on Playhouse Square, 1350 Euclid Avenue, Suite 650, Cleveland, OH 44115
(216) 592-2951

Ohio and part of upstate New York (the counties of Monroe, Livingston, and Steuben, and the remainder of the state west of such counties)

2003 District 8 Incoming Members

Thomas M. McDonald McDonald Investments, Inc. Cleveland, OH

James J. Roth Pershing Division of Donaldson, Lufkin
& Jenrette Securities Corporation Oak Brook, IL

2003 District 8 Nominating Committee Incoming Members

Wallen L. Crane Salomon Smith Barney, Inc. Toledo, OH

Mary D. Esser Cressman Esser Securities, Inc. Naperville, IL

Wayne F. Holly Sage, Rutty & Co., Inc. Rochester, NY

L. Gene Tanner NatCity Investments, Inc. Indianapolis, IN

Rodney Trautvetter Harris Direct Chicago, IL

District Committee and District Nominating Committee 2003 Incoming Members

District 9

John P. Nocella, District Director

Eleven Penn Center, 1835 Market Street, Suite 1900, Philadelphia, PA 19103
(215) 963-1992

Delaware, Pennsylvania, West Virginia, District of Columbia, Maryland, and the southern part of New Jersey in the immediate Philadelphia vicinity

Gary K. Liebowitz, District Director

581 Main Street, 7th Floor, Woodbridge, NJ 07905
(732) 596-2025

New Jersey (except southern New Jersey in the immediate Philadelphia vicinity)

2003 District 9 Incoming Members

Robert M. Berson	Ryan, Beck & Co., LLC	Livingston, NJ
Richard Grobman	Fahnestock & Co., Inc.	Philadelphia, PA
W. Dean Karrash	Rutherford, Brown & Catherwood, LLC	Philadelphia, PA
Michael S. Mortensen	PNC Investments, a division of J.J.B. Hilliard, W.L. Lyons, Inc. (two-year term)	Pittsburgh, PA

2003 District 9 Nominating Committee Incoming Members

A. Louis Denton	Philadelphia Corporation for Investment Services	Philadelphia, PA
James D. Lamke	Goldman, Sachs & Co.	Jersey City, NJ
Lance A. Reihl	1717 Capital Management Company	Berwyn, PA
Lenda P. Washington	GRW Capital Corporation	Washington, DC
Gregory R. Zappala	RRZ Public Markets, Inc.	Cranberry Township, PA

**District Committee and District Nominating Committee
2003 Incoming Members**

District 10

Cathleen F. Shine, District Director

One Liberty Plaza, 49th Floor, New York, NY 10006
(212) 858-4180

The five boroughs of New York City and Long Island

2003 District 10 Incoming Members

Raymond C. Holland, Sr.	Triad Securities Corp.	New York, NY
Vicki Z. Holleman	Loeb Partners Corporation	New York, NY
Andrew H. Madoff	Bernard L. Madoff Investment Securities LLC	New York, NY
Richard J. Paley	Fox-Pitt, Kelton Inc.	New York, NY

2003 District 10 Nominating Committee Incoming Members

Kevin J. Browne	Banc of America Securities	New York, NY
Judith R. MacDonald	Rothschild, Inc.	New York, NY
Eugene A. Schlanger	Nomura Holding America, Inc.	New York, NY
Stephen C. Strombelline	Barclays Capital Inc.	New York, NY
Tom M. Wirtshafter	American Portfolios Financial Services, Inc.	Holbrook, NY

**District Committee and District Nominating Committee
2003 Incoming Members**

District 11

Frederick F. McDonald, District Director

260 Franklin Street, Suite 1600, Boston, MA 02110
(617) 261-0805

Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont, and New York
(except for the counties of Monroe, Livingston, and Steuben; the five boroughs of New York
City; and Long Island)

2003 District 11 Incoming Members

Mark R. Hansen	State Street Global Markets, LLC	Boston, MA
Gregg A. Kidd	Pinnacle Investments, Inc.	East Syracuse, NY
Lee G. Kuckro	Advest, Inc.	Hartford, CT

2003 District 11 Nominating Committee Incoming Members

Stephen O. Buff	Fleet Securities, Inc.	Boston, MA
Richard J. DeAgazio	Boston Capital Services, Inc.	Boston, MA
John D. Lane	Lane Capital Markets LLC	Fairfield, CT
Dennis R. Surprenant	Cantella & Co., Inc.	Boston, MA
Peter T. Wheeler	Commonwealth Financial Network	Waltham, MA

Notice to Members

FEBRUARY 2003

SUGGESTED ROUTING

Legal & Compliance
Senior Management

KEY TOPICS

Consultative Committees
District Committees
Enforcement Actions
Market Regulation Committee

INFORMATIONAL

NASD Establishes Consultative Committees

Executive Summary

NASD regulatory staff believes that greater industry input into its investigatory process would be particularly valuable in responding to emerging regulatory issues, particularly given the technological and marketplace developments that have taken place over the past few years. To provide staff with a resource for obtaining the benefits of industry expertise during the course of an investigation, NASD has established Consultative Committees, on a pilot basis. NASD also has developed procedures for the operation of these committees that provide staff with flexibility to obtain information from industry representatives without compromising the staff's autonomy in performing its regulatory obligations.

Questions/Further Information

Questions concerning this *Notice to Members* may be directed to Jeffrey S. Holik, Senior Vice President, Member Regulation, at (202) 728-8387, or Katherine A. Malfa, Vice President, Enforcement, at (202) 974-2853.

Background

During the course of an investigation, NASD staff may encounter situations where industry expertise would be a useful resource. Such situations may arise, for example, as the result of new or complex securities products, technological developments, or industry practices. In these instances, NASD staff could benefit from industry experience to provide information on the background, operation, or scope of these products, developments or practices so

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that the staff can heighten its understanding regarding the extent to which the product, development, or practice raises regulatory concern. NASD believes consultation with industry representatives for this purpose produces more informed regulation.

It is critical that consultations by NASD staff with industry representatives do not impinge on the staff's independence and autonomy in deciding whether and how to investigate or prosecute any particular matter. To ensure that the staff has the ability to obtain information on industry practices and developments in connection with an investigation without raising concerns about the staff's independence, NASD has established, on a pilot basis, Consultative Committees that will be available to the staff as a source of industry-related information. NASD also has developed guidelines concerning the operation of these committees to ensure that the committees are consulted and provide services in an appropriate manner.¹

Consultative Committees

NASD has established one Consultative Committee for each NASD region that will be responsible for providing information to NASD staff on issues arising out of investigations. Each Consultative Committee will be composed of former District Committee members from the Committees in their region. Former District Committee 10 members and former Market Regulation Committee industry members together will be treated as representatives of one region for these purposes and will comprise one Consultative Committee.²

Former District Committee members eligible to serve on Consultative Committees are those who have just

completed their third year of a three-year term and are not being reappointed to the District Committee. These representatives will be invited to serve two-year terms on the Consultative Committee for their region, and may continue to participate beyond the two years as necessary to complete the consultation process on a matter that was pending before the two-year term expired. Each Consultative Committee will range in size from approximately six to nine members during the first year of operation, and contain between approximately twelve and eighteen members thereafter.

Consultative Committee members will be required to sign, at the beginning of their term, an agreement that contains provisions regarding confidentiality and conflicts of interest. In addition, members will be advised at each meeting of the confidential nature of the matters presented to them. Members also will be reminded at each meeting that their function is strictly advisory and they will have no role in determining whether a regulatory proceeding will be initiated in any matter. Further, staff will be advised that there are no circumstances in which it may ask Consultative Committee members whether NASD should initiate a proceeding.

NASD has adopted internal procedures to ensure that this program does not impinge upon the independence of NASD staff and to coordinate this program with NASD's other regulatory operations. For example, NASD staff will be permitted to seek information from a Consultative Committee only when authorized to do so by a District Director or the Executive Vice President from Market Regulation or Enforcement (or their designees). Further, if the appropriate staff authorizes a consultation with a Consultative

Committee, the staff will maintain careful records of the consultation with the Consultative Committee and will provide this information to the relevant departments of NASD. These procedures maintain the staff's independence and ensure that the Consultative Committees will not influence inappropriately determinations to bring disciplinary actions. The procedures also ensure that the staff responsible for assigning hearing panelists to disciplinary matters is aware of those potential panelists who may be recused from a particular matter because they participated in a Consultative Committee meeting where the matter was discussed.

Endnotes

- 1 In response to a report issued by the SEC in 1996 pursuant to Section 21(a) of the Securities Exchange Act of 1934 (Section 21(a) Report), NASD undertook, among other things, to provide for the autonomy and independence of its staff with respect to disciplinary matters where the commercial interests of NASD's members could be inappropriately asserted. See Undertaking No. 4, Section 21(a) Report. The internal procedures established for the operation of Consultative Committees are consistent with the undertakings and principles of independence articulated in the Section 21(a) Report.
- 2 Information and documents concerning NASD staff discussions with members of the District Committees and Market Regulation Committee are exempt from discovery in NASD disciplinary proceedings pursuant to Rule 9251(b)(1) of the NASD Code of Procedure.

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Notice to Members

FEBRUARY 2003

SUGGESTED ROUTING

Legal & Compliance
Operations
Senior Management

SEC Approves Changes to Rule on Clearly Erroneous Transactions; Changes Effective Immediately

KEY TOPICS

NASD Rule 11890

Executive Summary

On January 22, 2003, the Securities and Exchange Commission (SEC) approved changes to NASD Rule 11890 regarding the handling of clearly erroneous transactions. The changes, which take effect immediately, are intended primarily to clarify the rule's scope and language rather than to modify the application of the rule to particular transactions. Important clarifications made by the rule change include the following:

- ◆ NASDAQ will adjudicate erroneous transaction complaints only if they concern transactions executed through NASDAQ systems and only if the parties to the transactions are readily identifiable.
- ◆ On its own motion, NASDAQ may nullify or modify any transaction that is executed or reported through a NASDAQ system, if NASDAQ determines that action is necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest.

Questions regarding this *Notice* may be directed to Richard Bush, Director, NASDAQ Market Operations, at (203) 385-6242; or John Yetter, Assistant General Counsel, Office of General Counsel, The NASDAQ Stock Market, Inc., at (202) 912-3039.

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Background

NASD Rule 11890 sets forth the process through which NASDAQ may review certain transactions and declare them null and void or otherwise modify their terms. Under the first part of the Rule, NASDAQ has authority to receive petitions from market participants requesting that designated officers of NASDAQ review the terms of a transaction and nullify or modify it if the transaction is found to be clearly erroneous.

The changes to this part of the Rule approved by the SEC:

- ▶ Clarify that market participants may petition for review of transactions executed through NASDAQ execution and communications systems – *i.e.*, SuperMontage, Primex, Liquidity Tracker, and CAES – but may not petition for review of transactions that are executed exclusively through non-NASDAQ systems, such as transactions that are internalized within an electronic communications network (ECN) or a market maker's internal execution system.
- ▶ Clarify that the Rule covers transactions executed through SuperMontage by a member of an exchange that trades NASDAQ securities pursuant to unlisted trading privileges (UTP Exchange). Thus, the rule covers transactions entered into with members of the Chicago Stock Exchange through SuperMontage, but does not cover transactions of UTP Exchanges that are not linked to SuperMontage.
- ▶ Clarify that the parties to reviewable transactions must be readily identifiable through NASDAQ's systems. To ensure that this

requirement is satisfied, parties filing complaints under the rule should provide clear information about the transaction(s) at issue, including the name of the security, the number of shares, the price, the contra broker, and the executing NASDAQ system.

- ▶ Clarify that information submitted by parties to NASDAQ must be received by NASDAQ within the time frames specified by the Rule. Specifically, a market participant may seek review by submitting a written complaint to NASDAQ Market Operations that is received by 10:30 a.m. for transactions occurring within the first half hour of the regular trading day, and within 30 minutes of the time of the transaction for all other transactions.

Under the second part of Rule 11890, NASDAQ has authority to nullify or modify transactions on its own motion. The changes to this part of the Rule approved by the SEC:

- ▶ Clarify that NASDAQ may exercise its authority in the event of (i) a disruption or malfunction in any of NASDAQ's systems, or (ii) extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest.
- ▶ Clarify that NASDAQ's authority extends to any transaction arising out of or reported through a NASDAQ quotation, execution, communication, or trade reporting system. In contrast to the first part of the Rule, which focuses on errors made by the parties to a specific trade, the focus of the second part of the Rule is on errors

that may affect numerous trades throughout the market. Accordingly, the amended Rule expressly authorizes NASDAQ to break not only trades executed through its systems, but also trades executed through the systems of members that are reported to NASDAQ. In recognition of the authority of other self-regulatory organizations, however, the Rule does not cover trades entered into exclusively through, or reported to, a UTP Exchange, nor does it cover ADF trades reported to NASD's TRACS system. However, NASDAQ will endeavor to coordinate its actions with other market centers in an attempt to achieve consistent treatment of trades executed outside of NASDAQ's jurisdiction.

- ▶ Provide that the authority conferred by the second part of the Rule may be exercised only by NASDAQ's President or an Executive Vice President designated by the President, who must act, except in extraordinary circumstances, within 30 minutes of detection of the transaction or transactions at issue, but in no event later than 3:00 p.m. on the next trading day.

The third part of Rule 11890 governs review of decisions under the Rule by the Market Operations Review Committee (MORC), a standing committee composed of representatives of member firms as well as "non-industry" representatives. The changes to this part of the Rule approved by the SEC:

- ▶ Provide that NASDAQ's President or a designated Executive Vice President may limit review by the MORC if he or she determines that the number of transactions affected by a decision to break or modify trades on NASDAQ's

own motion is such that the decision must be accorded immediate finality in order to maintain a fair and orderly market and to protect investors and the public interest. Although NASDAQ expects that it would use this authority only on rare occasions, NASDAQ believes that there will be circumstances in which review by the MORC of a large number of trades would be impractical and could expose market participants to unacceptable levels of risk.

- ▶ Clarify that determinations of NASDAQ officers that are not appealed are final and binding and constitute final action by NASD on the matter.
- ▶ Provide that it shall be considered conduct inconsistent with just and equitable principles of trade for a member to refuse to take action that is necessary to effectuate a final decision of a NASDAQ officer or the MORC.

Finally, the SEC approved a new section of the Rule to:

- ▶ Clarify that materials submitted to NASDAQ or the MORC must be submitted via facsimile machine and must be received within the time parameters specified by the rule (although, if requested, NASDAQ staff may authorize submission of materials via electronic mail on a case-by-case basis).¹ Materials shall be deemed received at the time indicated by a facsimile machine or computer that receives the materials. NASDAQ reserves the right to reject or accept material that is not received within the time parameters specified by the Rule.

-
- ▶ Clarify that NASDAQ may provide notice of determinations under the rule via facsimile machine, electronic mail, or telephone (including voice mail). However, in cases where an officer nullifies or modifies a large number of transactions pursuant to NASDAQ's authority to act on its own motion, individual notice may not be practicable. In that case, NASDAQ may provide notice to market participants via the NASDAQ Workstation II Service, a press release, or any other method reasonably expected to provide rapid notice to many market participants.

Endnote

- 1 For example, if a party wishes to submit, pursuant to subparagraph (a)(2)(A) of the amended rule, a large document containing supporting information, it may be preferable to submit the document via electronic mail. Electronic mail may be used only when specifically authorized by NASDAQ staff, however, because it is impossible to control the delivery time of electronic mail.

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TEXT OF AMENDMENTS

New text is underlined; deletions are bracketed.

11890. Clearly Erroneous Transactions

(a) Authority to Review Transactions Pursuant to Complaint of Market Participant

(1) Scope of Authority. [For the purposes of this Rule, the terms of a transaction are clearly erroneous when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.]

[2)] Officers of [The] Nasdaq [Stock Market, Inc. (“Nasdaq”)] designated by [the] its President [of Nasdaq] shall, pursuant to the procedures set forth in paragraph [(b)] (a)(2) below, have the authority to review any transaction arising out of the use or operation of any [automated quotation,] execution[, or,] or communication system owned or operated by Nasdaq and approved by the Commission, including transactions entered into by a member of a national securities exchange with unlisted trading privileges in Nasdaq-listed securities (a “UTP Exchange”) through such a system; provided, however, that the parties to the transaction must be readily identifiable by Nasdaq through its systems [excluding transactions arising from use of the Nasdaq Application of OptiMark]. A Nasdaq officer shall review transactions with a view toward maintaining a fair and orderly market and the protection of investors and the public interest. Based upon this review, the officer shall decline to act upon a disputed transaction if the officer believes that the transaction under dispute is not clearly erroneous[, or,]. [i)] If the officer determines the transaction in dispute is clearly erroneous, however, he or she shall declare that the transaction is null and void or modify one or more terms of the transaction. When adjusting the terms of a transaction, the Nasdaq officer shall seek to adjust the price and/or size of the transaction to achieve an equitable rectification of the error that would place the parties to a transaction in the same position, or as close as possible to the same position, as [that] they would have been in had the error not occurred. [Nasdaq shall promptly provide oral notification of a determination to the parties involved in a disputed transaction and thereafter issue a written confirmation of the determination.] For the purposes of this Rule, the terms of a transaction are clearly erroneous when there is an obvious error in any term, such as price, number of shares or other unit of trading, or identification of the security.

[(b) Procedures for Reviewing Transactions]

[(1)] (2) Procedures for Reviewing Transactions

(A) Any member, member of a UTP Exchange, or person associated with [a] any such member that seeks to have a transaction reviewed pursuant to paragraph (a)(1) hereof[,] shall submit a written complaint[, via facsimile or otherwise,] to Nasdaq Market Operations in accordance with the following time parameters:

[(A)] (i) for transactions occurring at or after 9:30 a.m., Eastern Time, but prior to 10:00 a.m., Eastern Time, complaints must be [submitted] received by Nasdaq by 10:30 a.m., Eastern Time; and

[(B)] (ii) for transactions occurring prior to 9:30 a.m., Eastern Time and at or after 10:00 a.m., Eastern Time, complaints must be [submitted] received by Nasdaq within thirty minutes.

[(2)] (B) Once a complaint has been received in accord with subparagraph [(b)(1)] (a)(2)(A) above:

[(A)] (i) the complainant shall have up to thirty (30) minutes, or such longer period as specified by Nasdaq staff, to submit any supporting written information concerning the complaint necessary for a determination under paragraph [(a)(2)] (a)(1)[, via facsimile or otherwise];

[(B)] (ii) the counterparty to the trade shall be [verbally] notified of the complaint via telephone by Nasdaq staff and shall have up to thirty (30) minutes, or such longer period as specified by Nasdaq staff, to submit any supporting written information concerning the complaint necessary for a determination under paragraph [(a)(2)] (a)(1)[, via facsimile or otherwise]; and

[(C)] (iii) either party to a disputed trade may request the written information provided by the other party pursuant to this subparagraph.

[(3)] (C) Notwithstanding subparagraph [(b)(2)] (a)(2)(B) above, once a party to a disputed trade communicates that it does not intend to submit any further information concerning a complaint, the party may not thereafter provide additional information unless requested to do so by Nasdaq staff. If both parties to a disputed trade indicate that they have no further information to provide concerning the complaint before their respective

thirty-minute information submission period has elapsed, then the matter may be immediately presented to a Nasdaq officer for a determination pursuant to paragraph [(a)(2)] (a)(1) above.

[(4)] (D) Each member, member of a UTP Exchange, or person associated with any such member [and/or person associated with a member] involved in the transaction shall provide Nasdaq with any information that it requests in order to resolve the matter on a timely basis notwithstanding the time parameters set forth in subparagraph [(b)(2)] (a)(2)(B) above.

[(5)] (E) Once a party has applied to Nasdaq for review, the transaction shall be reviewed and a determination rendered, unless both parties to the transaction agree to withdraw the application for review prior to the time a decision is rendered pursuant to paragraph [(a)(2)] (a)(1).

[(c)] (b) Procedures for Reviewing Transactions [Executed During System Disruptions or Malfunctions] on Nasdaq's Own Motion

In the event of (i) a disruption or malfunction in the use or operation of any [automated] quotation, execution, [or] communication, or trade reporting system owned or operated by Nasdaq and approved by the Commission, or (ii) extraordinary market conditions or other circumstances in which the nullification or modification of transactions may be necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest, the President of Nasdaq or any Executive Vice President designated by the President], acting through an officer designated by the President of Nasdaq pursuant to paragraph (a)(2)], may, on [its] his or her own motion, [pursuant to the standards set forth in paragraph (a), declare] review any transaction[s] arising out of or reported through [the use or operation of such systems during the period of such disruption or malfunction] any such quotation, execution, communication, or trade reporting system, including transactions entered into by a member of a UTP Exchange through the use or operation of such a system, but excluding transactions that are entered into through, or reported to, a UTP Exchange. A Nasdaq officer acting pursuant to this subsection may declare any such transaction null and void or modify the terms of [these] any such transaction[s] if the officer determines that (i) the transaction is clearly erroneous, or (ii) such actions are necessary for the maintenance of a fair and orderly market or the protection of investors and the public interest; provided, however, that, in the absence of extraordinary circumstances, [a] the [Nasdaq] officer must take action pursuant to this [paragraph] subsection within thirty (30) minutes of detection of the [erroneous] transaction(s)], but in no event later than [6]3:00 p.m., Eastern Time, on the next trading

day following the date of the trade at issue. [When Nasdaq takes action pursuant to this subparagraph, the member firms involved in the transaction shall be notified as soon as is practicable and shall have a right to appeal such action in accordance with paragraph (d)(1) below.]

[(d)] (c) Review by the Market Operations Review Committee (“MORC”)

(1) A member, member of a UTP Exchange, or person associated with [a] any such member may appeal a determination made under [paragraphs] subsection (a)(2) or (c) to the MORC. A member, member of a UTP Exchange, or person associated with any such member may appeal a determination made under subsection (b) to the MORC unless the officer making the determination also determines that the number of the affected transactions is such that immediate finality is necessary to maintain a fair and orderly market and to protect investors and the public interest. [provided such] An appeal must be [is] made in writing[, via facsimile or otherwise], and must be received by Nasdaq within thirty (30) minutes after the [member or person associated with a member receives verbal] person making the appeal is given notification of [such] the determination being appealed, except that if Nasdaq notifies the parties of action taken pursuant to paragraph [(c)] (b) after 4:00 p.m., [either party has until] the appeal must be received by Nasdaq by 9:30 a.m. the next trading day [to appeal]. Once a written appeal has been received, the counterparty to the trade will be notified of the appeal and both parties shall be able to submit any additional supporting written information[, via facsimile or otherwise,] up until the time the appeal is considered by the Committee. Either party to a disputed trade may request the written information provided by the other party during the appeal process. An appeal to the Committee shall not operate as a stay of the determination [made pursuant to paragraph (a)(2) or (c) above] being appealed. Once a party has appealed a determination to the Committee, the determination shall be reviewed and a decision rendered, unless both parties to the transaction agree to withdraw the appeal prior to the time a decision is rendered by the Committee. Upon consideration of the record, and after such hearings as it may in its discretion order, the Committee, pursuant to the standards set forth in [paragraph (a)] this section, shall affirm, modify, reverse, or remand the determination [made under paragraph (a)(2) or (c) above].

(2) The decision of the Committee pursuant to an appeal, or a determination by a Nasdaq officer that is not appealed, shall be final and binding upon all [any member or person associated with a member] parties and shall constitute final Association action on the matter in issue. Any [adverse] determination by a Nasdaq officer pursuant to paragraph (a)[(2)] or [(c)] (b) or any [adverse] decision by the Committee pursuant to paragraph [(d)] (c)(1) shall be rendered without prejudice as to the rights of the parties to the transaction to submit their dispute to arbitration.

(d) Communications

(1) All materials submitted to Nasdaq or the MORC pursuant to this Rule shall be submitted via facsimile machine and within the time parameters specified herein; provided, however, that if requested, Nasdaq staff may authorize submission of material via electronic mail on a case-by-case basis. Materials shall be deemed received at the time indicated by the equipment (i.e., facsimile machine or computer) receiving the materials. Nasdaq, in its sole and absolute discretion, reserves the right to reject or accept any material that is not received within the time parameters specified herein.

(2) Nasdaq shall provide affected parties with prompt notice of determinations under this Rule via facsimile machine, electronic mail, or telephone (including voicemail); provided, however, that if an officer nullifies or modifies a large number of transactions pursuant to subsection (b), Nasdaq may instead provide notice to parties via the Nasdaq Workstation II Service, a press release, or any other method reasonably expected to provide rapid notice to many market participants.

IM-11890. Refusal to Abide by Rulings of a Nasdaq Officer or the MORC

It shall be considered conduct inconsistent with just and equitable principles of trade for any member to refuse to take any action that is necessary to effectuate a final decision of a Nasdaq officer or the MORC under Rule 11890.

Notice to Members

FEBRUARY 2003

SUGGESTED ROUTING

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

KEY TOPICS

Debt Securities
Dissemination
Operations
Rule 6200 Series
Transaction Reporting

INFORMATIONAL

Corporate Debt Securities

SEC Approves Amendments to TRACE Rule 6250 and Other TRACE Rules: Transaction Information to be Disseminated on More than 4,000 Corporate Debt Securities

Executive Summary

On January 31, 2002, the Securities and Exchange Commission (SEC or Commission) approved amendments to Rule 6250 of the Trade Reporting and Compliance Engine (TRACE) rules, the Rule 6200 Series.¹ The amendments to TRACE Rule 6250 will allow NASD to begin disseminating transaction information on more than 4,000 qualifying Investment Grade corporate debt securities.² The SEC also approved minor changes to Rule 6210(e), the definition of "customer to a transaction," and Rule 6260. The rules, as amended, are set forth in Attachment A.

The amendments to the TRACE Rules will become effective on March 3, 2003, with one exception. New paragraph (a)(4) of Rule 6250, providing for the dissemination of 90 corporate debt securities that are rated "triple-B," will become effective shortly thereafter, on a date to be announced in a future *Notice to Members*. Currently, NASD is in the process of identifying the 90 specific securities that will be subject to dissemination, and will announce the effective date of Rule 6250(a)(4) when the process is complete.

Questions/Further Information

Questions concerning this *Notice* should be directed to tracefeedback@nasd.com; Elliot Levine, Chief Counsel, Market Operations, Regulatory Services and Operations, at (212) 858-4174; or Sharon K. Zackula, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985.

03-12

Background and Discussion

NASD began requiring members to report transaction information on all TRACE-eligible corporate debt securities on July 1, 2002. At that time, NASD also began disseminating information on transactions occurring in approximately 540 TRACE-eligible securities. Specifically, under Rule 6250, transactions in two types of securities were subject to the TRACE dissemination requirements that took effect on July 1, 2002: (1) those transactions in a TRACE-eligible security having an initial issuance size of \$1 billion or greater that is Investment Grade at the time of receipt of the transaction report as set forth in Rule 6250(a)(1); and (2) those transactions in 50 TRACE-eligible securities that are actively traded, Non-Investment Grade,³ and meet other criteria set forth in Rule 6250(a)(2). At the time that TRACE began, NASD also was obligated and intended to require the dissemination of additional securities in the future.

Amendments to Increase Dissemination

NASD formed an advisory committee, the Bond Transaction Reporting Committee (BTRC), composed of 10 representatives, to study issues relating to transparency and increased dissemination of the universe of TRACE-eligible securities. With the concurrence of the BTRC, in early December 2002, NASD proposed to add the following two groups of securities to the list of securities that are subject to dissemination under Rule 6250. The SEC approved the proposed rule change on January 31, 2003.

First, in Rule 6250(a)(3), as approved, NASD will disseminate transaction information on any TRACE-eligible security that is Investment Grade; is rated by Moody's Investors Service, Inc. as "A3" or higher,⁴ and by Standard & Poor's, a division of McGraw Hill Co., Inc., as "A-" or higher;⁵ and has an original issue size of \$100 million or greater. In addition, a security that is required to be disseminated under the criteria above, on or after the effective date of this provision, will continue to be subject to dissemination unless the security is downgraded below "Baa3/BBB-."

Second, in Rule 6250(a)(4), as approved, NASD is required to disseminate transaction information on 90 TRACE-eligible securities designated by NASD that are rated "Baa/BBB" at the time of designation. As discussed in greater detail below, NASD will announce the effective date of this provision in a future *Notice to Members*, upon completing the process of identifying the 90 securities to be disseminated according to the criteria set forth in the Rule.

Other Changes

The SEC also approved two additional minor rule changes to the TRACE Rules. First, in Rule 6210(e), NASD clarified the term "party to the transaction" to mean a customer, in addition to an introducing broker/dealer, if any, and an executing broker/dealer. Also, for the purposes of Rule 6210(e), "customer" includes a broker/dealer that is not an NASD member.⁶

Rule 6260 generally requires a managing underwriter of a new TRACE-eligible security to provide to the TRACE Operations Center, within certain deadlines established in the rule, the following six types of information with respect to the new security: (1) a CUSIP number identifying the security; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; and (6) a brief description of the issue. The SEC approved minor changes to clarify that if any of items (2) through (6) have not been determined at the time that the managing underwriter is required to submit the information, the managing underwriter may discuss with NASD submitting such other information "as NASD deems necessary." However, a managing underwriter must always submit the CUSIP number. Other minor changes are set forth in Attachment A.

Effective Date

The amendments to the TRACE Rules will become effective on March 3, 2003, with one exception. New paragraph (a)(4) of Rule 6250, providing for the dissemination of 90 TRACE-eligible corporate debt securities that are rated "triple-B," will become effective shortly thereafter.

Extending the effective date for Rule 6250(a)(4) allows NASD to appropriately identify the 90 securities that will become subject to dissemination in accordance with the criteria in the Rule. Under paragraph (a)(4) of Rule 6250, NASD is required to identify 90 securities, by identifying three groups of 30 TRACE-eligible securities (Group 1, Group 2, and Group 3). At the time of designation,

each TRACE-eligible security in Group 1 must be rated "Baa1/BBB+" and each TRACE-eligible security in Groups 2 and 3 must be rated, respectively, "Baa2/BBB" and "Baa3/BBB-." In addition, if a TRACE-eligible security has a rating from only one rating agency, it may not be designated. When the process of identification and designation is complete, NASD will announce the effective date of Rule 6250(a)(4) in a subsequent *Notice to Members* and transaction information on the 90 securities will begin to be disseminated.

Endnotes

- 1 See Securities Exchange Act Release No. 47302 (January 31, 2003), 68 Fed. Reg. 6233 (February 6, 2003) (File No. SR-NASD-2002-174).
- 2 "Investment Grade" is defined in Rule 6210(h) to mean "any TRACE-eligible security rated by a nationally recognized statistical rating organization in one of its four highest generic rating categories."
- 3 "Non-Investment Grade" is defined in Rule 6210(i) to mean "any TRACE-eligible security that is unrated, non-rated, split-rated (where one rating falls below Investment Grade), or otherwise does not meet the definition of Investment Grade...."
- 4 Moody's Investor 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.

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- 5 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 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 S&P's prior written consent.
 - 6 In contrast, in Rule 0120(g), NASD defines the term "customer" to exclude a broker or a dealer.

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ATTACHMENT A

Text of Rule Changes.

Note: New language is underlined; deletions are in brackets.

6200. TRADE REPORTING AND COMPLIANCE ENGINE (TRACE)

6210. Definitions

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

(a) through (d) No change.

(e) The term "party to the transaction" ["parties to the transaction"] shall mean [the]an introducing broker-dealer, if any, [and the]an executing broker-dealer, or a customer. For purposes of this Rule, customer includes a broker-dealer that is not an NASD member.

(f) through (i) No change.

* * * * *

6250. Dissemination of Corporate Bond Trade Information

(a) General Dissemination Standard

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

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

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

(A) through (B) No change.

(3) A TRACE-eligible security that is Investment Grade, is rated by Moody's Investors Service, Inc. as "A3"¹ or higher, and by Standard & Poor's, a division of McGraw Hill Co., Inc., as "A-"² or higher, and has an original issue size of \$100 million or greater. If a security is rated under this provision to qualify for dissemination at any time on or after the effective date of the rule, dissemination of transaction information on the security will continue under this paragraph unless the security is downgraded below Baa3/BBB-.

(4) Ninety TRACE-eligible securities designated by NASD that are rated Baa/BBB at the time of designation, according to the following standards.

(A) Three groups composed of 30 TRACE-eligible securities (Group 1, Group 2, and Group 3) shall be designated by NASD. At the time of designation, each TRACE-eligible security in Group 1 must be rated "Baa1/BBB+;" and each TRACE-eligible security in Group 2 and Group 3, must be rated, respectively, "Baa2/BBB," and "Baa3/BBB-," provided that if a TRACE-eligible security is rated one of the "Baa" ratings by Moody's and one of the "BBB" ratings by S&P and the ratings indicate two different levels of credit quality, the lower of the two ratings will be used to determine the group to which a debt security will be assigned under paragraph (a)(4).

(B) A TRACE-eligible security that has a rating from only one rating agency will not be designated under paragraph (a)(4).

1. 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.

2. 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.

(C) Dissemination of transaction information on a TRACE-eligible security that is designated under paragraph (a)(4) will not be discontinued if one rating is, or both ratings, are downgraded or upgraded.

(b) through (d) No change.

6260. Managing Underwriter Obligation To Obtain CUSIP

(a) No change.

(b) For such TRACE-eligible securities, the managing underwriter must provide to the TRACE Operations Center: (1) the CUSIP number; (2) the issuer name; (3) the coupon rate; (4) the maturity; (5) whether Rule 144A applies; and (6) a brief description of the issue (e.g., senior subordinated note, senior note), or if any of items (2) through (6) [such information] has not been determined, such other information as [the]NASD deems necessary. The managing underwriter must obtain the CUSIP number and provide it and the information listed as (2) through (6) not later than 5:00 p.m. on the business day preceding the day that the registration statement becomes effective, or, if registration is not required, the day before the securities will be priced. If an issuer notifies [an] 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 [member] 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 [member]managing underwriter shall provide the information not later than 5:00 p.m. on the next business day. [A member] 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.

Disciplinary and Other NASD Actions

REPORTED FOR FEBRUARY

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 January 2003.

Firm and Individual Sanctioned

Security Capital Trading, Inc. n/k/a Vertical Capital Partners, Inc. (CRD #35909, New York, New York) and Ronald Mark Heineman (CRD #241924, Registered Principal, Fair Field, New Jersey) submitted an Offer of Settlement in which the firm was fined \$75,000 and suspended from participating in any firm commitment underwritings in any underwriting capacity for six months, and suspended thereafter for an additional 18 months from participating in any firm commitment underwritings as a lead managing underwriter. In light of the firm's payment of \$50,000 in a settlement, the fine was reduced to \$25,000. Heineman was fined \$50,000 and suspended from association with any NASD member in any capacity for two months. The fines imposed reflect the financial status of the firm and Heineman. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm executed an underwriting "letter of intent" in which it agreed to underwrite an initial public offering (IPO) "on a firm commitment basis." The firm, acting through Heineman, terminated the issuer's firm commitment offering without justification after four days of aftermarket trading and requested that NASDAQ cancel all trades. The termination affected over 500 members and their clearing agents, and public customers whose trades had to be unwound and canceled. In addition, the issuer failed to receive the \$10.98 million (less fees and discounts) in proceeds it was entitled to receive under the firm commitment underwriting agreement.

The firm's suspension from participating in any firm commitment underwritings in any underwriting capacity began January 21, 2003, and will conclude July 20, 2003. The firm's suspension from participating in any firm commitment underwriting as a lead managing underwriter will begin July 21, 2003, and will conclude at the close of business January 20, 2005. Heineman's suspension began January 21, 2003, and will conclude at the close of business March 20, 2003. (NASD Case #CAF020032)

Firms Fined, Individuals Sanctioned

Laidlaw Global Securities, Inc. (CRD #19018, New York, New York) and Philip Roger Howard Connor, III (CRD #1579819, Registered Principal, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$50,000. Connor was fined \$25,000 and suspended from association with any NASD member in any capacity for three weeks. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm and Connor sold securities of Laidlaw's parent company without a registration statement, and that the firm executed solicited sales of unregistered, restricted Rule 144 stock. The findings also stated that the firm failed to file public offerings with NASD's Corporate Finance Department, and to meet other substantive requirements when it sold securities from its principal accounts.

Connor's suspension began February 3, 2003, and will conclude at the close of business February 21, 2003. (NASD Case #CAF020070)

Pacific On-Line Trading and Securities, Inc. (CRD #45737, San Jose, California) and Timothy Alan McAdams (CRD #2877024, Registered Principal, San Jose, California) were censured and fined \$22,500, jointly and severally, and McAdams was required to requalify as a general securities principal. The National Adjudicatory Council (NAC) modified the sanctions following appeal of an Officer of Hearing Officers (OHO) decision. The sanctions were based on findings that the firm, acting through McAdams, maintained a Web site advertisement without filing the site with NASD. The findings also stated that the firm, acting through McAdams, used a Web site that was false and misleading because it omitted material information concerning the risks of day trading and contained exaggerated, unwarranted, and false statements.

The firm and McAdams have appealed this action to the Securities and Exchange Commission (SEC), and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C01000037)

Firms and Individuals Fined

Glen Rauch Securities, Inc. (CRD #17843, New York, New York) and Dennis Young (CRD #2070952, Registered Principal, Forest Hills, New York) submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$10,000, jointly and severally. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Young, permitted registered representatives to act as registered persons while their registration status with NASD was inactive due to their failure to complete the

Regulatory Element of NASD's Continuing Education Requirement. (NASD Case #C10020121)

J.P.R. Capital Corporation (CRD #38056, Roslyn, New York) and Paul Jeffrey Umansky (CRD #1615489, Registered Principal, Rockville Centre, New York) submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$15,000, jointly and severally. The firm was fined \$5,000, jointly and severally, with another individual, and fined \$6,500, individually. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through Umansky, failed to establish, maintain, and enforce adequate written procedures for supervising the telemarketing activities of all of the firm's registered persons as required by the Taping Rule. The findings also stated that the firm, acting through an individual, failed to report, and to report timely, statistical and summary information regarding written customer complaints. NASD also found that the firm executed short-sale transactions in NASDAQ National Market® (NNM®) securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. (NASD Case #CLI020015)

Firms Fined

A.B. Watley, Inc. (CRD #797, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$45,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to show the time of execution on the memorandum of each purchase and sale for the firm's account. The findings also stated that the firm executed principal short sale-transactions and failed to report each of the transactions to the Automated Confirmation Transaction ServiceSM (ACTSM) with a short-sale modifier. In addition, the firm executed customer short-sale orders and failed to properly mark the customer order tickets as "short." (NASD Case #CLI020014)

Adams, Harkness & Hill, Inc. (CRD #1020, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$25,000. 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 locked/crossed the market during the pre-opening period and failed to immediately thereafter send a Trade-or-Move message through SelectNet® to the market participant whose quote it locked or crossed that was priced at the receiving market participant's quoted price; and failed to send a Trade-or-Move message through SelectNet with an aggregate size of at least 5,000 shares to all market participants whose quotes it locked/crossed. The findings also stated that the firm 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 Case #CMS020267)

American Enterprise Investment Services Inc. (CRD #26506, Minneapolis, Minnesota) 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 accept or decline in ACT transactions in eligible securities within 20 minutes after execution. (NASD Case #CMS020256)

Banca IMI Securities Corporation (CRD #19418, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$17,500, and required to revise its written supervisory procedures with respect to applicable securities laws and regulations concerning Order Audit Trail SystemSM (OATSSM) rules. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it submitted to OATS reports with respect to equity securities traded on the NASDAQ Stock Market that were not in the electronic form prescribed by NASD. NASD found that the subject reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web Site, but the firm did not correct or replace the subject reports during the review period. The findings also stated that the firm failed to submit required information to OATS, and transmitted to OATS reports that contained inaccurate, incomplete, or improperly formatted data. Furthermore, NASD found that the firm failed to timely report to OATS reportable order events, and its supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning OATS. (NASD Case #CMS020248)

Budner Securities n/k/a Secure Trading Group, Inc. (CRD #41216, Boca Raton, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it effected short sales on a down tick at or below the current best bid for the security, failed to report short sales via the ACT system as required, and failed to mark sell order tickets as short when it executed short sales. The findings also stated that the firm entered proprietary trades into the Small Order Execution SystemSM (SOESSM) for execution against a SOES market maker. In addition, NASD found that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with the rules and regulations applicable to the

Short Sale Rule, ACT trade reporting, recordkeeping, and SOES trading. (NASD Case #C07020100)

Cardinal Capital Management, Inc. (CRD #24605, Miami, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was fined \$12,500. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it executed principal equity transactions for its own account as well as public customer accounts through its clearing firm and failed to have someone registered as an equity trader. The findings also stated that the firm failed to make filings pursuant to the customer complaint-reporting requirement, although it had an arbitration award and customer complaints that were reportable. (NASD Case #C07020101)

Clark Street Capital, Inc. (CRD #38304, Alpharetta, Georgia) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it assisted in the operation of an unregistered broker/dealer by opening and maintaining day trading brokerage accounts for public customers of the unregistered broker/dealer. The findings also stated that the firm paid commissions to the unregistered broker/dealer as income for services. (NASD Case #CAF020068)

Herzog, Heine, Geduld, LLC (CRD #2186, Jersey City, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$40,000. The firm has submitted satisfactory proof of payment of restitution, or reasonable and documented efforts undertaken to pay restitution, to its customers in connection with its handling and execution of customer orders. 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 executed customer market orders to sell and buy shares, and customer limit orders to buy shares. NASD found that the firm did not send any SelectNet messages, except one, to buy or sell shares from market makers or electronic communications networks (ECNs) to satisfy its customers' orders. The findings also stated that the firm failed to price-improve one customer market order to sell shares of a common stock by executing it against an undisclosed limit order to buy shares of the stock. (NASD Case #CMS020266)

Instinet Corporation (CRD #42886, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that in both print and television advertisements, it failed to disclose the basis for the savings numbers contained in the ads and how the numbers were derived. The findings also stated that the firm failed to disclose that the savings numbers were not based on actual

trades, as implied, but were derived from calculations performed by the firm based on market analysis by an outside firm not identified as the source of the analysis. In addition, NASD found that a print ad failed to establish any correlation between the rankings identified and the claimed savings. NASD also found that the ads, as presented, failed to provide a sound basis to permit the public to evaluate the facts in regards to the services offered. (NASD Case #CAF020069)

J.P.R. Capital Corporation (CRD #38056, Roslyn, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to revise its written supervisory procedures with respect to the applicable securities laws and regulations concerning the OATS rules within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to submit required information to OATS on 44 business days. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws and regulations concerning OATS rules. (NASD Case #CMS020262)

National Securities Corp. (CRD #7569, Seattle, Washington) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$32,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it received customer complaints that were to be disclosed on Forms U-4 (Uniform Applications for Securities Industry Registration or Transfer) and/or U-5 (Uniform Termination Notices for Security Industry Registration) of registered representatives and failed to do so. The findings also stated that the firm settled written customer complaints, which settlements were supposed to be disclosed on Forms U-4 and/or U-5 of certain registered representatives, but failed to do so. NASD also found that the firm permitted a registered person to continue to perform duties as a registered person when his registration status with NASD was inactive due to his failure to complete the Regulatory Element of NASD's Continuing Education Requirements. In addition, NASD found that the firm maintained a continuing education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism; and, in the implementation of that program, failed to maintain an adequate system to monitor the completion of continuing education modules by its registered persons. Moreover, NASD found that the firm failed to establish, maintain, and/or enforce adequate written supervisory procedures and failed otherwise to supervise its activities to achieve compliance with applicable securities laws and regulations concerning the timely reporting of customer complaints and settlements on Forms U-4 and/or U-5, preventing registered persons from continuing to perform duties as a registered person when their registration status with NASD is inactive due to failure to complete the Regulatory Element of NASD's Continuing Education Requirements, and monitoring and documenting the completion of Firm Element of continuing

education modules by its registered persons. (NASD Case #C3B020023)

Needham & Company, Inc. (CRD #16360, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$65,000, jointly and severally, and required to pay \$915.12, plus interest, in restitution to a public customer. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it traded for its own account ahead of customer limit orders, failed to use reasonable diligence to ascertain the best inter-dealer market, 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, and failed to execute customer limit orders. The findings also stated that the firm failed to display immediately the customer limit orders in listed securities in its public quotation, when each such order was at a price that would have improved the firm's bid or offer in each such security; or when the order was priced equal to the firm's bid or offer and the national best bid or offer in such security, and the size of the order represented more than a de minimis change in relation to the size associated with its bid or offer in each such security. In addition, NASD found that the firm failed to establish, maintain, and enforce adequate written supervisory procedures to achieve compliance with applicable securities laws and regulations concerning the Limit Order Protection/Display rules and regulations. (NASD Case #C8A020087)

ViewTrade Securities, Inc. (CRD #46987, Boca Raton, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last-sale reports of transactions in NNM, NASDAQ SmallCapSM (SCSM), and OTC Equity securities, and failed to designate through ACT OTC Equity securities last-sale reports as late. The findings also stated that the firm incorrectly designated as ".SLD" through ACT last-sale reports of transactions in OTC Equity securities reported to ACT within 90 seconds of execution, and incorrectly designated as ".PRP" through ACT last-sale reports of transactions in NNM, OTC Equity, and SC securities reported to ACT. (NASD Case #CMS020253)

Wells Fargo Investments, LLC (CRD #10582, San Francisco, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$30,000, and required to pay \$4,178.60, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to ensure that it used reasonable diligence to ascertain the best inter-dealer market, and that it bought or sold in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions.

The findings also stated that 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. (NASD Case #CMS020258)

Individuals Barred or Suspended

Mark David Allen (CRD #1763329, Registered Principal, South Glastonbury, 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, Allen consented to the described sanction and to the entry of findings that he misappropriated \$3,455 in cash premium payments he received from clients. The findings stated that instead of applying the premium payments to the customers' auto insurance policies, Allen misappropriated the funds for his own use and benefit. (NASD Case #C11020047)

Christian Gardner Baldwin (CRD #4413418, Associated Person, Hicksville, 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 three months. The fine must be paid before Baldwin reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Baldwin consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Uniform Application for Securities Industry Registration or Transfer Form (Form U-4).

Baldwin's suspension began February 3, 2003, and will conclude at the close of business May 2, 2003. (NASD Case #C10020129)

Stephen Allan Blum (CRD #600373, Registered Representative, New York, New York) 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 principal capacity for three months. Without admitting or denying the allegations, Blum consented to the described sanctions and to the entry of findings that, acting on behalf of a member firm, he utilized the instrumentalities of interstate commerce to conduct a securities business while failing to maintain its minimum required net capital.

Blum's suspension began February 18, 2003, and will conclude May 17, 2003. (NASD Case #C9B020087)

William Lawrence Boettcher (CRD #24768, Registered Representative, Walworth, Wisconsin) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Boettcher

reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Boettcher consented to the described sanctions and to the entry of findings that he failed to disclose material facts on his Form U-4.

Boettcher's suspension began February 18, 2003, and will conclude at the close of business March 19, 2003. (NASD Case #C8A020094)

Sarah L. Colbert (CRD #4152203, Associated Person, Addison, Texas) submitted an Offer of Settlement in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Colbert consented to the described sanction and to the entry of findings that she wrote a personal check in the amount of \$800 in payment of her monthly rent that was subsequently returned for insufficient funds and was advised by her landlord that she would be subject to a daily late fee unless she could prove that her check was returned as a result of a bank error. The findings stated that Colbert, in order to avoid the late penalty, obtained blank stationery from her member firm, composed a letter stating the reason her check was returned was due to a bank error, forged the name of a former bank officer on the letter knowing that the officer was no longer with the firm, and sent or gave the letter to her landlord. (NASD Case #C06020016)

Thomas John DeSimone (CRD #2228767, Registered Representative, Staten Island, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, DeSimone consented to the described sanction and to the entry of findings that he willfully failed to amend, or to amend timely, his Form U-4 to disclose material information. (NASD Case #C10020133)

Frank Thomas Devine (CRD #2035363, Registered Representative, Oswego, Illinois) was fined \$34,825.42, suspended from association with any NASD member in any capacity for 90 days, and required to requalify by exam as an investment company and variable contracts products representative. The SEC affirmed the sanctions following appeal of a NAC decision. The sanctions were based on findings that Devine engaged in private securities transactions without providing prior written notice to, or receiving written permission from, his member firm.

Devine's suspension began February 18, 2003, and will conclude May 18, 2003. (NASD Case #C8A990026)

Roy Grant Dillabaugh (CRD #842429, Registered Representative, Dayton, 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, Dillabaugh consented to the described sanction and to the entry of findings that he received \$5,000 from public customers to purchase a

“Certificate of Deposit Note” that was not a legitimate investment vehicle. The findings also stated that he failed to invest their funds, created a “Certificate of Deposit Note” to mislead the customers into believing that he was selling them a certificate of deposit, and used the customer funds for personal gain. (NASD Case #C8B020029)

Robert Anthony DiMinico (CRD #1339697, Registered Principal, Los Angeles, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that DiMinico bid for, purchased, and induced others to purchase warrants while engaged in a secondary distribution of the warrants. The findings also stated that DiMinico failed to file, or to have his member firm file, with NASD certain information and documents regarding the proposed terms of a secondary distribution of warrants, and that his firm, through DiMinico, received underwriting compensation that was unfair and unreasonable. NASD also found that DiMinico improperly cancelled retail customers’ purchases of shares of common stock while the shares remained available in the aftermarket following the IPO. (NASD Case #CAF000027)

Stephanie Ann Dixon (CRD #4217627, Associated Person, Tempe, Arizona) was fined \$5,000, suspended from association with any NASD member in any capacity for six months, and required to complete the Continuing Education Regulatory Element within one year following any securities industry registration. The fine must be paid before Dixon reassociates with any NASD member. The sanctions were based on findings that Dixon provided a false response on a Form U-4 and failed to respond in a timely manner to NASD requests for information.

Dixon’s suspension began January 6, 2003, and will conclude July 5, 2003. (NASD Case #C3A020020)

Joseph Charles Favata, Sr. (CRD #2254467, Registered Representative, Albrightsville, Pennsylvania) was barred from association with any NASD member in any capacity. The sanction was based on findings that Favata failed to respond to NASD requests for information. Favata also engaged in outside business activities and failed to give prompt written notice to his member firm. (NASD Case #C9A020035)

John Joseph Fisher (CRD #208642, Registered Representative, Wantagh, New York) submitted an Offer of Settlement in which he was fined \$6,950, suspended from association with any NASD member in any capacity for 30 days, and required to pay \$8,050 in restitution to public customers. Without admitting or denying the allegations, Fisher consented to the described sanctions and to the entry of findings that he received commissions as the introducing broker based on the activity in a public customer’s account that resulted in the customer’s account being turned over 783 times on an annualized basis, and the cost/equity ratio was 100 percent, which constitutes churning. The findings also stated that Fisher caused a public customer to sign margin guarantee agreements

guaranteeing the margin accounts for five other customers at his member firm that were not reasonable in light of the customer’s age, mental and physical condition, financial situation, and lack of investment sophistication.

Fisher’s suspension began February 3, 2003, and will conclude at the close of business March 4, 2003. (NASD Case #C3A010036)

William Henry Gehron, III (CRD #219307, Registered Representative, Williamsport, Pennsylvania) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Gehron consented to the described sanction and to the entry of findings that he received a \$77,875 check from a public customer to purchase securities, negotiated the check by endorsing it, and deposited it into his personal bank account. The findings also stated that Gehron issued a \$58,000 check to the order of the public customer, caused the funds to be applied to the purchase of securities for the customer, and retained the \$19,875 balance for his personal purposes until he later paid over the funds to the member firm with which he was then associated. (NASD Case #C9A020053)

Michael Edward Golden (CRD #224128, Registered Principal, Boca Raton, Florida) submitted an Offer of Settlement in which he was fined \$20,000 and suspended from association with any NASD member in any principal or supervisory capacity for two months. Without admitting or denying the allegations, Golden consented to the described sanctions and to the entry of findings that he permitted an individual to hold the position of Director of Investment Banking and to be identified as his member firm’s principal responsible for underwriting, investment banking, and due diligence and to engage in the conduct of related activities notwithstanding that he was not registered as a principal. The findings also stated that Golden failed to take actions or measures that were necessary, reasonable, and adequate to preclude the individual from performing functions and engaging in conduct requiring registration as a principal until he was properly registered.

NASD also found that Golden failed to detect and prevent his member firm’s submission of Free-Riding Questionnaires to NASD that were materially false, misleading, and/or inaccurate in its participation in offerings that were hot issues. In addition, NASD found that Golden effected purchases of hot issues in his personal account, accounts in which he had a beneficial interest, and the account of an investment partnership for which he was the representative in contravention of NASD’s “Free-Riding and Withholding” Interpretation. Moreover, NASD found that Golden failed to ensure that his member firm established and maintained a supervisory system that designated an appropriately registered principal with authority to carry out his firm’s supervisory responsibilities for its underwriting and investment banking business. Furthermore,

Golden, directly or indirectly, failed to ensure that his member firm established, maintained, and enforced written policies and supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules.

Golden's suspension began February 3, 2003, and will conclude at the close of business April 2, 2003. (NASD Case #C9A020027)

Bradley Allen Hafner (CRD #2927378, Registered Representative, Granger, Indiana) submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Hafner consented to the described sanctions and to the entry of findings that he willfully failed to disclose a material fact on his Form U-4. The findings also stated that Hafner willfully failed to amend, or cause to have amended, his Form U-4 while he was registered with a member firm to disclose a material fact.

Hafner's suspension began February 18, 2003, and will conclude August 17, 2003. (NASD Case #C8A020031)

Dawn Sylvette Harper (CRD #4382289, Registered Representative, Mesquite, Texas) was barred from association with any NASD member in any capacity. The sanction was based on findings that Harper failed to respond to NASD requests for information. Harper also failed to disclose a material fact on her Form U-4. (NASD Case #C05020023)

David Alan Haugk (CRD #4117538, Associated Person, Beaverton, Oregon) 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, Haugk consented to the described sanction and to the entry of findings that he placed duplicate shares of common stock inadvertently delivered to his member firm by a transfer agent into an account that he owned or controlled, without the knowledge or consent of the firm or the transfer agent. (NASD Case #C3B020022)

Todd William Hawley (CRD #1988486, Registered Representative, McLean, Virginia) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$25,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Hawley reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hawley consented to the described sanctions and to the entry of findings that he had ownership and control of two accounts and knowingly and intentionally entered pairs of offsetting orders for NASDAQ securities with identical prices and quantities into the Island Electronic Communication Network (ISLD). The findings also stated that the execution of the matched, offsetting orders resulted in the sale of securities from Hawley's trading account

and the purchase of the same securities by his IRA account and then the repurchase of those same securities by his trading account from his IRA account. NASD determined that the repurchase by his trading account from his IRA account occurred at higher prices than the IRA account originally paid for the securities. In addition, NASD found that as result of this trading, Hawley's trading account realized losses and his IRA account realized gains.

Hawley's suspension began February 18, 2003, and will conclude August 17, 2003. (NASD Case #CMS020239)

Alan Jay Huber, Jr. (CRD #1593345, Registered Representative, Wilton, Connecticut) 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, Huber consented to the described sanctions and to the entry of findings that he coordinated prices, trades, and trade reports in connection with the sale of a common stock with the intent to purchase the same shares from a third party. NASD also found that Huber was discharged from his member firm for violating firm policy and procedures in connection with the sells.

Huber's suspension began February 18, 2003, and will conclude at the close of business March 3, 2003. (NASD Case #CMS020265)

Darius Darnell Isabell (CRD #4344819, Associated Person, New Brighton, Minnesota) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Isabell reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Isabell consented to the described sanctions and to the entry of findings that he willfully failed to disclose a material fact on his Form U-4.

Isabell's suspension began February 3, 2003, and will conclude at the close of business February 2, 2004. (NASD Case #C04020046)

Theodora Kenneybrew (CRD #2660317, Registered Representative, Chino, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Kenneybrew converted and misused funds belonging to public customers in that she received \$75,474.73 in checks for investment purposes; failed and neglected to invest the funds as instructed; and instead, without the knowledge or consent of the customers, endorsed and deposited the checks into a bank account over which she had control and used \$62,474.73 of the funds for her own personal benefit or for some purpose other than the benefit of the customers. NASD also found that Kenneybrew, without her member firm's knowledge or consent, transferred \$10,200 from

a customer's retirement account to the customer's cash management account; and authored and signed, under the name of a fictitious supervisor, a letter on firm letterhead, through which she misrepresented to a customer that a back-office error had resulted in her deposit being credited to the wrong account and that the error was being corrected. (NASD Case #C02020041)

Alton King, Jr. (CRD #811008, Registered Representative, Longmeadow, Massachusetts) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for six months. In light of the financial status of King, no monetary sanction has been imposed. Without admitting or denying the allegations, King consented to the described sanctions and to the entry of findings that he did not provide his member firm with prompt written notice that he had undertaken a business activity with another firm wherein he received compensation.

King's suspension began February 18, 2003, and will conclude August 17, 2003. (NASD Case #C11020044)

Sundarajan Krishnaswamy (CRD #3167021, Registered Representative, Piscataway, New Jersey) 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. The fine must be paid before Krishnaswamy reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Krishnaswamy consented to the described sanctions and to the entry of findings that he gave \$180 to a public customer to settle the customer's complaint concerning commissions charged on a municipal bond transaction, without the knowledge or consent of his member firm.

Krishnaswamy's suspension began February 3, 2003, and will conclude at the close of business February 14, 2003. (NASD Case #C9B020093)

Jon Kwan Lee (CRD #2538075, Registered Principal, Bayside, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Lee interfered with customer account transfer requests. (NASD Case #C3A020032)

Eric Rau Lupo (CRD #2646738, Registered Supervisor, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Lupo reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Lupo consented to the described sanctions and to the entry of findings that he effected transactions in the account of a public customer without the

customer's prior knowledge, authorization, or consent. The findings also stated that Lupo induced a public customer to purchase shares of a NASDAQ security by promising to place a stop loss order on the shares purchased and failed to do so, resulting in an approximate loss of \$58,825 to the customer. NASD also found that Lupo, while registered with a member firm, sent letters to a public customer concerning his failure to place a stop loss order in the customer's account, one of which was on firm stationery, without the firm's prior approval, thus preventing the firm from discharging its obligation to review outgoing correspondence of its registered representatives with the public relating to the firm's securities business.

Lupo's suspension began January 21, 2003, and will conclude at the close of business January 20, 2004. (NASD Case #C10020128)

Daniel Dwight Manoff (CRD #1720001, Registered Representative, Poolesville, Maryland) was barred from association with any NASD member in any capacity. The SEC affirmed the decision following the appeal of the NAC decision. The sanction was based on findings that Manoff made unauthorized use of a co-worker's credit card numbers. (NASD Case #C9A990007)

Heriberto Marrero (CRD #1696583, Registered Representative, Fort Lauderdale, Florida) 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, Marrero consented to the described sanction and to the entry of findings that he converted \$44,093.35 from the bank accounts of public customers without their authorization to his own use by preparing debit and credit memos containing the forged signatures of the customers. The findings also stated that Marrero failed to respond to NASD requests for information. (NASD Case #C07020086)

Taunya Patrice McGee (CRD #4381115, Registered Representative, Upper Marlboro, Maryland) 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, McGee consented to the described sanction and to the entry of findings that she made multiple unauthorized withdrawals totaling \$4,380 from a checking account and/or a savings account owned by a customer and used the funds for her own benefit. The findings also stated that McGee submitted loan applications for \$6,200 in the names of customers without their knowledge or consent, caused the loan proceeds to be paid to her, and used the funds for her own benefit. NASD also found that McGee failed to respond to NASD requests for information and documents. (NASD Case #C9A020056)

Samuel Earl Miller, II (CRD #2479590, Registered Representative, Louisville, Kentucky) was barred from association with any NASD member in any capacity. The sanction

was based on findings that Miller received \$1,000 from a public customer for investment purposes, failed and neglected to remit the funds to his member firm, and failed to invest the funds as instructed. NASD also found that Miller created and sent to a public customer a false account statement reflecting a fictitious mutual fund purchase in the customer's account. In addition, Miller failed to respond to NASD requests for information. (NASD Case #C05020042)

Peter J. Morena (CRD #4383972, Associated Person, Fairview Heights, Illinois) was barred from association with any NASD member in any capacity. The sanction was based on findings that Morena failed to respond to NASD requests for information. In addition, Morena willfully failed to disclose material facts on his Form U-4. (NASD Case #C8A020025)

Douglas Paul Nichols (CRD #4141283, Registered Representative, Broomfield, Colorado) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for six months. In light of the financial status of Nichols, no monetary sanction has been imposed. Without admitting or denying the allegations, Nichols consented to the described sanction and to the entry of findings that he willfully failed to disclose material facts on his Form U-4.

Nichols' suspension began February 3, 2003, and will conclude August 3, 2003. (NASD Case #C3A020046)

Mark Douglas Nienhueser (CRD #2343074, Registered Representative, Jefferson City, Missouri) 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 10 business days. The fine must be paid before Nienhueser reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Nienhueser consented to the described sanctions and to the entry of findings that he engaged in outside business activities and accepted compensation while failing to provide prompt written notice to his member firm of such activities.

Nienhueser's suspension began February 3, 2003, and concluded at the close of business February 14, 2003. (NASD Case #C04030001)

Roy Robert Peachey (CRD #2283766, Registered Representative, Belleville, Pennsylvania) 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 disgorge \$50,000 in commissions in partial restitution to public customers. Restitution must be paid before Peachey requests relief from any statutory disqualification. Without admitting or denying the allegations, Peachey consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, or approval from, his member firm. (NASD Case #C9A020054)

Bruce Alan Pivar (CRD #1231443, Registered Principal, Highland Park, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member in any capacity for 10 business days, and barred from association with any NASD member in a principal or supervisory capacity. Without admitting or denying the allegations, Pivar consented to the described sanctions and to the entry of findings that a registered representative tendered to Pivar personal checks and asked Pivar for permission to effect transactions in Pivar's account. The findings stated that Pivar agreed and the checks were deposited in Pivar's personal brokerage account. NASD found that the representative then directed Pivar to buy and sell options in his account for the representative's benefit using the funds. In addition, NASD found that Pivar placed trades with the funds in his personal account solely on behalf of the representative, including the sale of uncovered options. Furthermore, the findings stated that Pivar knew or should have known that the representative was restricted by his firm from effecting uncovered options transactions.

Pivar's suspension began February 18, 2003, and will conclude at the close of business March 3, 2003. (NASD Case #C8A030002)

Suzanne Renee Preuss (CRD #2680193, Registered Principal, Plano, Texas) was barred from association with any NASD member in any capacity. The sanction was based on findings that Preuss fraudulently issued firm checks to herself by forging the signature of the firm's president and then cashed the checks and applied the proceeds to her own use and benefit. NASD also found that Preuss failed to respond to an NASD request to appear and give testimony in an on-the-record interview. (NASD Case #C06020008)

Elizabeth Virginia Revelle (CRD #2496718, Registered Representative, Mt. Freedom, New Jersey) was barred from association with any NASD member in any capacity. The sanction was based on findings that Revelle failed to respond to NASD requests for information. In addition, Revelle failed to return a computer to her former member firm upon demand. (NASD Case #C9B020068)

Vincent Ribortone (CRD #2614091, Registered Representative, Freeport, New York) submitted an Offer of Settlement in which he was fined \$7,382.97, including disgorgement of commissions received of \$4,882.97, suspended from association with any NASD member in any capacity for six months, required to requalify in all capacities for which registration is sought, and required to pay \$14,606.97 in restitution to public customers. The fine and restitution amounts must be paid before Ribortone reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Ribortone consented to the described

sanctions and to the entry of findings that he entered unauthorized transactions in public customers' accounts. The findings also stated that Ribortone made baseless price predictions concerning the future performance of a pending IPO.

Ribortone's suspension began February 3, 2003, and will conclude August 2, 2003. (NASD Case #C3A020044)

Michelle Marie Rispole (CRD #4427835, Associated Person, Quincy, Massachusetts) was barred from association with any NASD member in any capacity. The sanction was based on findings that Rispole willfully failed to disclose a material fact on her Form U-4. The findings also stated that Rispole failed several times to respond to NASD requests for information. (NASD Case #C11020032)

James Theodore Robinson (CRD #4337581, Associated Person, Rockford, Illinois) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for nine months. In light of the financial status of Robinson, no monetary sanctions have been imposed. Without admitting or denying the allegations, Robinson consented to the described sanction and to the entry of findings that he failed to disclose material facts on his Form U-4. The findings also stated that Robinson failed to respond to NASD requests for information.

Robinson's suspension began February 3, 2003, and will conclude November 2, 2003. (NASD Case #C04020019)

David Rogers (CRD #4043357, Registered Representative, Scotts Valley, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was censured, fined \$7,500, and suspended from association with any NASD member in any capacity for 120 days. The fine must be paid before Rogers reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Rogers consented to the described sanctions and to the entry of findings that, without the customer's knowledge or consent, he signed the name of a public customer to a letter of authorization that purported to authorize the transfer of securities from another firm to Roger's firm and caused the letter of authorization to be submitted to the transfer agent.

Rogers' suspension began January 21, 2003, and will conclude at the close of business May 20, 2003. (NASD Case #C01020026)

Patrick Alan Sanders (CRD #2784897, Registered Representative, Bismarck, 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, Sanders consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form

U-4. The findings also stated that Sanders failed to respond to NASD requests for information. (NASD Case #C04020044)

Jamie K. C. Scher (CRD #2839788, Registered Representative, Woodbury, New York) submitted an Offer of Settlement in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Scher consented to the described sanction and to the entry of findings that she failed to provide accurate, non-deceptive, and/or complete statements during an NASD on-the-record interview. (NASD Case #C10990158)

Carl Eugene Scipione (CRD #3000672, Registered Representative, Sea Girt, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$15,000, suspended from association with any NASD member in a principal capacity for two months, and required to requalify by exam as a financial and operations principal within 90 days. The fine must be paid before Scipione reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Scipione consented to the described sanctions and to the entry of findings that, acting on behalf of a member firm, he utilized the instrumentalities of interstate commerce to conduct a securities business while failing to maintain the firm's minimum required net capital.

Scipione's suspension began January 6, 2003, and will conclude at the close of business March 5, 2003. (NASD Case #C9B020086)

Andrew Sirico (CRD #1848034, Registered Principal, Bayport, 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 three months. Without admitting or denying the allegations, Sirico consented to the described sanctions and to the entry of findings that he settled a public customer's written complaint alleging sales practice violations by paying the customer \$6,000 without informing and obtaining authorization from his member firm.

Sirico's suspension began January 6, 2003, and will conclude April 5, 2003. (NASD Case #CLI020012)

Richard Allen Sitomer (CRD #1995999, Registered Principal, New York, New York) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and ordered to pay \$4,565.30, plus interest, in restitution to public customers. Satisfactory proof of payment of the restitution must be made before Sitomer reassociates with any NASD member. Without admitting or denying the allegations, Sitomer consented to the described sanctions and to the entry of findings that, acting on behalf of his member firm, he employed in various capacities and entered into a consulting agreement with a statutorily disqualified person. The findings also stated that Sitomer executed unauthorized transactions in

the accounts of public customers without the customers' prior knowledge, authorization, or consent. In addition, NASD found that Sitomer failed to take appropriate steps to detect and prevent the conduct giving rise to claims and/or complaints alleging unauthorized transactions involving an employee. (NASD Case #C04020030)

Douglas Richard Stewart (CRD #3181828, Registered Representative, West St. Paul, Minnesota) 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, Stewart consented to the described sanction and to the entry of findings that he obtained a \$2,200 unused draft authorization check for the securities account of a public customer, and without the knowledge or consent of the customer, converted the funds to his own use and benefit by making the check payable to himself, endorsing the check, and depositing it into his personal bank account. The findings also stated that Stewart failed to respond to NASD requests for information. (NASD Case #C04020043)

David Earl Sullivan (CRD #2796365, Registered Representative, Boca Raton, Florida) was barred from association with any NASD member in any capacity. The sanction was based on findings that Sullivan stole a blank check belonging to a former member firm; made the check payable to himself for \$800 without the firm's knowledge, authorization, or consent; and forged the signature of the firm's managing partner on the check. The findings also stated that Sullivan endorsed and cashed the check, thereby converting the \$800. (NASD Case #C10020059)

Richard Scott Taylor (CRD #1558263, Registered Representative, Mitchellville, Maryland) 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 disgorge \$250,000 in commissions in partial restitution to public customers. Restitution must be paid before Taylor requests relief from any statutory disqualification. Without admitting or denying the allegations, Taylor consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, or approval from, his member firm. (NASD Case #C9A020055)

Patrick Allen Thomas (CRD #1668667, Registered Representative, Huntington Beach, 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, Thomas consented to the described sanction and to the entry of findings that he participated in private securities transactions without providing prior written or oral notification to, and receiving approval from, his member firm. (NASD Case #C02020058)

Paul J. Thompson (CRD #3116125, Registered Representative, Bayfield, Colorado) 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, Thompson consented to the described sanctions and to the entry of findings that he caused the purchase of shares of a mutual fund offered by his member firm in the joint securities accounts of public customers without authorization by the customers.

Thompson's suspension began February 3, 2003, and will conclude at the close of business March 4, 2003. (NASD Case #C3A020055)

Kenneth Chuan Wang (CRD #3125876, Registered Representative, Old Greenwich, Connecticut) 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, Wang consented to the described sanctions and to the entry of findings that he coordinated prices, trades, and trade reports in connection with the sell of a common stock with the intent to purchase the same shares from a third party. NASD also found that Wang was permitted to resign from his member firm in connection with the sells.

Wang's suspension began February 18, 2003, and will conclude at the close of business March 3, 2003. (NASD Case #CMS020264)

John George Widmer (CRD #1913061, Registered Representative, Pagosa Springs, Colorado) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Widmer consented to the described sanction and to the entry of findings that he converted \$161,000 from a public customer's account maintained at his member firm for his own use and benefit without the customer's prior knowledge, authorization, or consent. (NASD Case #C3A020056)

Individual Fined

Coley James Neel (CRD #2805737, Registered Principal, Chicago, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which he was censured; fined \$100,000; required to pay \$30,375, plus interest, in disgorgement; and required to requalify by exam as a general securities representative, registered principal, and equity trader with NASD within 90 days. Without admitting or denying the allegations, Neel consented to the described sanctions and to the entry of findings that he failed, in transactions for or with a customer, to use reasonable diligence to ascertain the best inter-dealer

market, and to buy or sell in such market so that the resultant price to a customer was as favorable as possible under prevailing market conditions. (NASD Case #CMS020246)

Decisions Issued

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

Chris Dinh Hartley (CRD #1799834, Registered Representative, San Jose, California) was fined \$7,500 and suspended from association with any NASD member in any capacity for 30 days. The sanctions were based on findings that Hartley participated in private securities transactions and failed to give prior written notice to, and receive written approval from, his member firm prior to engaging in such activities.

This case has been called for review by the NAC, and the sanctions are not in effect pending consideration of the review. (NASD Case #C01010009)

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

Puma has appealed this decision to the NAC, and NASD's Department of Enforcement has cross-appealed the decision to the NAC. The sanctions are not in effect pending consideration of the appeal. (NASD Case #C10000122)

Complaints Filed

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

John Thomas Archer (CRD #6890, Registered Representative, Escondido, California), Alvin Waino Gebhart, Jr. (CRD #1005905, Registered Principal, Fallbrook, California), and Donna Traina Gebhart (CRD #2708528, Registered Principal, Fallbrook, California) were named as

respondents in an NASD complaint alleging that they, directly or indirectly, made use of the means or instrumentalities of transportation or communication in interstate commerce or of the mails to offer to sell securities in the form of promissory notes; or directly or indirectly carried or caused such securities to be carried through the mails or in interstate commerce for the purpose of sale or for delivery after sale of the securities. The complaint also alleges that Archer, A. Gebhart, and D. Gebhart, directly or indirectly, in connection with the purchase or sale of securities, by the use of the means or instrumentalities of interstate commerce or of the mails, employed devices, schemes, or artifices to defraud; made untrue statements of material fact or omitted to state material facts necessary in order to make the statements, in light of the circumstances under which they were made, not misleading; and engaged in acts, practices, or courses of business which operated, or would operate, as a fraud or deceit upon purchasers or prospective purchasers in contravention of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The complaint also alleges that Archer, A. Gebhart, and D. Gebhart participated in private securities transactions without providing prior written notification to, and receiving approval from, their member firms. The complaint further alleges that Archer acted as a broker without the benefit of registration as required by Section 15 of the Exchange Act. (NASD Case #C02020057)

Stanley Crawford Armour (CRD #2729805, Registered Representative, Pearl River, New York) was named as a respondent in a complaint alleging that he engaged in a securities transaction in the account of a public customer without the customer's knowledge or consent, and withdrew approximately \$72,500 from the customer's savings account without the customer's knowledge or consent to pay for the unauthorized securities transaction. The complaint also alleges that Armour forged the customer's signature on a customer acknowledgement form without the customer's knowledge or consent. (NASD Case #C9B020091)

Erik Antony Baron (CRD #2450380, Registered Representative, Brookfield, Connecticut) was named as a respondent in an NASD complaint alleging that he effected a transaction in the account of a public customer without the customer's prior knowledge, authorization, or consent. The complaint also alleges that Baron sent an electronic correspondence to a public customer without the prior knowledge or approval of his member firm, thereby preventing his firm from discharging its supervisory obligation to review outgoing correspondence of its registered representatives with the public relating to its securities business. In addition, the complaint alleges that Baron made a material misrepresentation in the electronic communication to a public customer. Moreover, the complaint alleges that Baron requested his member firm's clearing firm to grant additional time to a public customer to pay for a purchase of securities pursuant to Regulation T of the Interpretation of the Board of Governors of the Federal Reserve

System and failed to exercise good faith in making this extension request on behalf of the customer. Furthermore, the complaint alleges that Baron falsely testified during an NASD on-the-record interview. (NASD Case #C10020126)

Brookes McIntosh Bendetsen (CRD #1374304, Registered Principal, San Mateo, California) was named as a respondent in an NASD complaint alleging that he signed the name of a public customer to a margin agreement for the account of the customer's trust account. The complaint alleges that Bendetsen recommended to a public customer and effected in the customer's account short sales of shares and purchases of shares of stock, and the writing of a series of purchases and sales of option contracts, without having a reasonable basis for believing that the transactions were suitable for the customer based on the facts disclosed by the customer as to other security holdings, financial situation, and needs. The complaint also alleges that Bendetsen created and provided to a public customer false account statements relating to the customer's account at his member firm. (NASD Case #C01020025)

Douglas Conant Day (CRD #1131612, Registered Principal, San Jose, California) was named as a respondent in an NASD complaint alleging that he recommended to public customers the purchase of an investment contract without having reasonable grounds for believing that the recommendation was suitable for the customers based upon the facts disclosed by the customers as to their other security holdings and their financial situation and needs. The complaint also alleges that Day refused to respond to NASD requests for information and documents, and provided false information to NASD during the course of an investigation. (NASD Case #C01020024)

Darrell Todd Gibson (CRD #2833174, Registered Representative, McGregor, Texas) was named as a respondent in an NASD complaint alleging that he engaged in a private securities transaction without providing prior written notice to, and receiving approval from, his member firm. The complaint alleges that Gibson recommended to public customers the purchase of a promissory note without having a reasonable basis based on the customers' financial status, objectives, and needs. The complaint also alleges that Gibson sold securities to customers without being properly registered with NASD, and failed to respond to NASD requests for information. (NASD Case #C06020024)

Hornblower and Weeks, Inc. (CRD #4683, New York, New York) and Paul Eric Tobaoda (CRD #2033981, Registered Representative, Wantagh, New York) were named as respondents in an NASD complaint alleging that Tobaoda wrote a research report issued by the firm that made exaggerated, unwarranted, and misleading statements and claims about a company; failed to disclose material facts; and failed to disclose important risks associated with the company. The complaint also alleges that the firm and Tobaoda issued the report in violation of the terms of an NASD Letter of Acceptance, Waiver, and

Consent in which the firm was required to hire an independent consultant to review the adequacy of their supervisory procedures relating to the issuance of research reports before issuing a research report, and in which the firm was required to notify NASD before issuing a research report. (NASD Case #CAF020022)

Daniel Eric Kelsey (CRD #3031423, Registered Representative, Grand Rapids, Michigan) was named as a respondent in an NASD complaint alleging that Kelsey, by the use of instrumentalities of interstate commerce or the mails, intentionally or recklessly employed devices to defraud customers by making untrue statements of material facts and/or omitting to state material facts necessary to make the statements made by Kelsey, in light of the circumstances in which they were made, not misleading in connection with the purchase by customers of variable life insurance policies that Kelsey sold to the customers. The complaint also alleges that Kelsey willfully failed to update his Form U-4 with material facts, and that he willfully and affirmatively misrepresented material information on his Form U-4. In addition, the complaint alleges that Kelsey willfully failed to disclose material facts on his Form U-4. (NASD Case #C8A020088)

Kelli O'Brien Milz (CRD #2956890, Registered Representative, Marietta, Georgia) was named as a respondent in an NASD complaint alleging that she aided and abetted the operation of an unregistered broker/dealer by permitting it to run its business through the branch office of a member firm that she managed by causing new accounts to be opened for customers of the unregistered broker/dealer at her member firm with herself listed as the registered representative. The complaint also alleges that Milz paid, or caused to be paid, transaction-based compensation to the unregistered broker/dealer, and that she created a customer account system that tracked the commissions due each office of the unregistered broker. In addition, the complaint alleges that Milz assisted in the preparation of Web sites for the unregistered broker/dealer that promoted its unregistered brokerage services, and provided access to new account forms that created the false and misleading impression that it offered brokerage services. (NASD Case #CAF020067)

Terry Lamar Obee (CRD #2326611, Registered Representative, Richton Park, Illinois) was named as a respondent in an NASD complaint in which he received \$125,000 from a public customer for investments in real estate ventures, but then transferred the funds to his personal brokerage account at his member firm and converted the funds to buy and sell options for his own account without the knowledge or consent of the customer. The complaint alleges that Obee's member firm placed a restriction on options trading in his brokerage account at the firm to permit option writing only and, despite the restriction, he tendered \$40,000 to his supervisor at the firm to be deposited into the supervisor's brokerage account and directed options transactions in the

account, circumventing restrictions placed on his personal brokerage account. The complaint also alleges that Obee failed to respond to NASD requests for information. (NASD Case #C8A020092)

Aurangzeb Rashid Pirzada (CRD #868883, Registered Principal, Los Angeles, California) was named as a respondent in an NASD complaint alleging that he willfully failed to disclose material facts on his Form U-4. The complaint alleges that Pirzada willfully failed to amend his Form U-4 to disclose a material fact. The complaint further alleges that Pirzada, in connection with the sales of securities in a public customer's 401(k) and Individual Retirement Account (IRA) accounts, utilized the instrumentalities of interstate commerce to engage in a device, scheme, and artifice to defraud in that he represented to a public customer that he would manage her funds in a new IRA account, but used the funds to make a clearing deposit for his member firm with another broker/dealer and engaged in day trading through an account captioned "Pasha Research" to pay his own personal expenses. In addition, the complaint alleges that, in connection with the sale of securities to a public customer, Pirzada failed to disclose material facts to the customer. (NASD Case #C01020027)

Joseph John Piscopo (CRD #2221826, Registered Representative, Staten Island, New York) and Peter Laurella (CRD #2386054, Registered Representative, Staten Island, New York) were named as respondents in an NASD complaint alleging that they knowingly and deceptively participated in a scheme pursuant to which they executed securities transactions in the accounts of public customers without their knowledge, authorization, or consent. The complaint also alleges that Piscopo and Laurella, by use of the means and instrumentalities of interstate commerce and of the facilities of national securities exchanges, employed a device, scheme, or artifice to defraud; made untrue statements of material fact; omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and engaged in acts, practices, or a course of business which operated, or could operate, as a fraud or deceit upon persons in connection with the purchase and sale of securities. In addition, the complaint alleges that Piscopo and Laurella failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #CAF020065)

Kenneth Harold Rodgers (CRD #2694136, Registered Representative, Milltown, New Jersey) was named as a respondent in an NASD complaint alleging that, while exercising effective control over the account of a public customer, he recommended numerous purchase and sale transactions without having reasonable grounds for believing that the transactions were suitable for the customer in view of the size and frequency of the transactions, the nature of the account, and the customer's financial situation and needs. (NASD Case #C9B020088)

Edwardo Xavier Sosa (CRD #2703160, Registered Representative, New York, New York) was named as a respondent in an NASD complaint alleging that he solicited public customers to purchase common stock and warrants, opened brokerage accounts in their names at his member firm, and purchased stock and warrants in the accounts without the customers' authorization. (NASD Case #CAF020071)

John Kevin Toupin (CRD #1777676, Registered Principal, Clayton, Georgia) was named as a respondent in an NASD complaint alleging that he caused a public customer to forward \$300,000 to him to be used to purchase investment company shares, deposited the funds into an account in his name, and failed to invest the funds as directed. The complaint also alleges that Toupin failed to respond to NASD requests for information and documents. (NASD Case #C07030001)

Firm Suspended Pursuant to NASD Rule Series 9510 for Failure to Comply with an Arbitration Award, a Settlement Agreement, or Arbitration Fees

(The date the registration was suspended is included after the entry. If the firm has complied, the listing also includes the date the suspension was lifted.)

Hornblower and Weeks, Inc.
New York, New York
(January 6, 2003)

Individuals Barred Pursuant to NASD Rule 9544 for Failure to Provide Information Requested Under NASD Rule 8210

(The date the bar became effective is listed after the entry.)

Harris, Michael O.
W. Los Angeles, California
(January 3, 2003)

Hernandez, Ulisses R.
Queens, New York
(December 20, 2002)

Kimes, Kody Frederick
Cottage Grove, Oregon
(January 3, 2003)

Lee, Jon Kwan
Bayside, New York
(December 17, 2002)

Merced, Carlos E.
Victorville, California
(December 17, 2002)

Silverberg, Jay Steven
Los Angeles, California
(January 8, 2003)

Stapleton, Bill L.,
Weilerbach, Germany
(December 18, 2002)

Visbal, Michael A.,
Pacific Palisades, California
(December 17, 2002)

Individuals Suspended Pursuant to NASD Rule 9541(b) for Failure to Provide Information Requested under NASD Rule 8210

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

Cope, Anthony D.
Coraopolis, Pennsylvania
(December 30, 2002)

Cope, Jason
Coraopolis, Pennsylvania
(December 11, 2002)

Harris, James Sheridan
Duncanville, Texas
(December 24, 2002)

Holmes, Leslie R.
Upper Marlboro, Maryland
(December 23, 2002)

Mason, Gregory A.
New York, New York
(December 31, 2002)

Miranda, Peter S.
Highland Park, Illinois
(December 12, 2002)

Reese, Daniel B.
Cleburne, Texas
(January 3, 2003)

Schwartz, Robert A.
Los Angeles, California
(December 30, 2002)

Unger, Oron
Brooklyn, New York
(December 12, 2002)

Vivino, Jr., Anthony E.
Lansdale, Pennsylvania
(December 19, 2002)

Waye, II, Gary C.
Rochester, New York
(December 30, 2002)

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

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

Cappetta, Vincent
North Babylon, New York
(January 7, 2003)

Gerson, Glenn H.
West Palm Beach, Florida
(December 17, 2002)

Louis, Andrew S.
San Diego, California
(January 3, 2003–January 13, 2003) [Suspension has been lifted for Louis.]

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

Guirand, Gary
Baldwin, New York
(December 19, 2002)

Johnson, Darryl S.
Prairie View, Texas
(December 19, 2002)

Lanza, Rafael M.
West New York, New Jersey
(December 19, 2002)

NASD Charges Robertson Stephens with Sharing in Millions of Dollars of Customers' Profits in Exchange for "Hot" IPO Shares; Firm to Pay \$28 Million to Settle NASD and SEC Actions

Robertson Stephens, Inc., has been censured and ordered to pay \$28 million for receiving inflated commissions from more than 100 client accounts in exchange for the allocation of "hot" initial public offerings (IPOs) in 1999 and 2000 during the height of the IPO boom. As part of its settlement with NASD and a related case brought by the Securities and Exchange Commission (SEC), Robertson Stephens will pay \$14 million to NASD and \$14 million in the SEC's matter.

Robertson Stephens' wrongful profit sharing took place in the firm's Institutional Sales Department and Financial Services Department. Customers of Institutional Sales shared profits with the firm by paying inflated brokerage commissions on unrelated listed trades. Inflated brokerage commissions were paid on thousands of transactions, mostly on the day of the IPO, or the day before or after the IPO. Hundreds of these trades were executed with commissions at \$1 per share or more, in contrast to the ordinary rate for such transactions: 6 cents per share. Customers also engaged in non-economic trades to share profits with the firm. In these trades, the customer purchased a highly liquid exchange-listed security through the firm, paying an inflated commission, and immediately sold the security at another firm at the ordinary commission rate, often resulting in an immediate loss for the customer. Many of these trades were executed as "market on open" or "market on close" in order to minimize market exposure.

The firm also engaged in unlawful profit sharing with its Financial Services customers through inflated markdowns on the sale of IPO shares back to the firm. These accounts "flipped" their shares back to the firm, and paid the high markdowns even though Robertson Stephens often did not charge any markdown on principal trades.

"Profit sharing with customers in connection with the allocation of IPO shares is a serious violation of NASD rules and severely undermines the integrity of the markets," said Mary L. Schapiro, NASD's Vice Chairman and President, Regulatory Policy & Oversight. "This scheme to inflate firm commissions in return for granting hot IPO allocations corrupts the capital raising process. We will continue to look at activity in this area to ensure that NASD rules are followed and investors are treated fairly."

In 1999 and 2000, Robertson Stephens was the lead manager of more than 75 IPOs, many of which traded in the immediate aftermarket at significant multiples of the IPO offering price—

one as high as 355 percent. NASD found that the firm allocated shares in these IPOs through a syndicate ranking formula weighted in favor of those accounts that generated commissions close in time to the IPO. Customer accounts paid the firm inflated commissions to increase their syndicate rank. The Syndicate Department also had discretion to allocate some IPO shares independent of the syndicate rank and, at times, provided greater allocations to accounts than they otherwise would have received based solely on their rank. NASD found that if certain accounts had not paid inflated commissions, they would not have attained the necessary status according to the syndicate rank formula and Robertson Stephens would not have allocated IPO shares to them. Certain accounts receiving hot IPOs engaged in virtually no other trading through Robertson Stephens other than transactions characterized by inflated commissions paid on the day of an IPO or within a day of the IPO. Other accounts generally paid the firm's normal commission rate of 6 cents per share, and then inflated the commission rate on the day of an IPO or within a day of an IPO. Certain accounts paid more than \$1 million in inflated commissions in return for IPO allocations.

NASD found that in order to obtain or increase their IPO allocations, certain institutional accounts determined a percentage of profits they needed to repay the firm, and certain accounts repaid 25-30 percent of their profits on successful IPO deals. On hot IPO days, many customers would place their orders for trades at the market's opening, but would not ascribe commissions on the trade until later in the day, after the customer determined how much money they made or would make by flipping the IPO.

Certain Robertson Stephens managers were told that the firm was sharing in profits. For example, a senior salesperson wrote to the head of Institutional Sales about an account that requested IPO shares,

"Because of their uncertainty about the level of upside to the deal, rather than commit to a fixed level of incremental commission \$(i.e. \$10,000 per 1,000 shares), [the customer has] committed to do incremental business equal to 30% of their profit.... This is a layup."

As part of its investigation, NASD also found that Robertson Stephens failed to preserve e-mails as required by record-keeping rules. During the course of the investigation into the practices outlined above, NASD requested certain e-mails. At that time, e-mails were retained on back-up tape. However, some time after receiving these requests, Robertson Stephens overwrote a number of the requested tapes, covering an eight-month period, and internal e-mails from those backup tapes were deleted. Such e-mails were possibly both responsive and relevant to the on-going investigation and some of these e-mails could not be reproduced through other means.

NASD found that Robertson Stephens's conduct violated NASD rules:

- ◆ prohibiting member firms from sharing in the profits of client accounts;
- ◆ obligating brokerage firms to adhere to just and equitable principles of trade;
- ◆ requiring information to be filed with NASD's Corporate Finance Department;
- ◆ requiring accurate books and records be maintained by brokerage firms; and
- ◆ requiring an adequate supervisory system.

Robertson Stephens, which is in the process of withdrawing from the securities industry, neither admitted nor denied the allegations but consented to the entry of findings. NASD acknowledges the assistance of the SEC in this matter.

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