

OCTOBER 2004

# Notices to Members

## Notices

<b>04-69</b>	Mandatory Use of Combined New Order/Route and Combined New Order/Execution Reports Delayed until April 4, 2005; Clarification of Combined Reporting Format Requirements for Related Order Information Submitted by Multiple Order Sending Organizations	833
<b>04-70</b>	Nominees for NASD Board of Governors	837
<b>04-71</b>	SEC Approves New Rules and Rule Amendments Concerning Supervision and Supervisory Controls; <b>Effective Date: January 31, 2005</b>	845
<b>04-72</b>	Impermissible Use of Negative Response Letters for the Transfer of Mutual Funds and Variable Annuities (Changes in Broker-Dealer of Record)	871
<b>04-73</b>	Amendments to Section 4 of Schedule A to the NASD By-Laws Governing Qualification Examination Fees; <b>Implementation Date: January 1, 2005</b>	875
<b>04-74</b>	Broker-Dealer, Investment Adviser Firm, Agent and Investment Adviser Representative Renewals for 2005; <b>Payment Deadline: December 6, 2004</b>	883
<b>04-75</b>	NASD Seeks Comment on Enhanced Disclosure for Subordination Agreements; <b>Comment Period Expires November 26, 2004</b>	893

continued



<b>04-76</b>	Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory	899
<b>04-77</b>	SEC Announces Approval of Amendment to NASD's Minor Rule Violation Plan (MRVP) to Include Failure to Timely Submit Amendments to Form U5; <b>Effective Date: November 22, 2004</b>	921
<b>04-78</b>	SEC Approves Amendments to Rule 1120 to Eliminate Exemptions from the Continuing Education Regulatory Element Requirements; <b>Effective Date: Anticipated April 2005; Specific Date to be Announced in Future <i>Notice to Members</i></b>	927

## Disciplinary and Other NASD Actions

Reported for October	D1
----------------------	----

---

©2004. NASD. All rights reserved.

*NASD Notices to Members* is published monthly by NASD Corporate Communications, 1735 K Street, NW, Washington, DC 20006-1500, (202) 728-8370. No portion of this publication may be copied, photocopied, or duplicated in any form or by any means, except as described below, without prior written consent of NASD. Members of NASD are authorized to photocopy or otherwise duplicate any part of this publication without charge only for internal use by the member and its associated persons. Nonmembers of NASD may obtain permission to photocopy for internal use through the Copyright Clearance Center (CCC) for a \$3-per-page fee to be paid directly to CCC, 222 Rosewood Drive, Danvers, MA 01923.

Each member firm's Executive Representative is entitled to one annual subscription to *Notices to Members* at cost (\$15 per year). Additional annual subscriptions are available for \$225; single issues cost \$25. To order, send a check or money order (payable to NASD) to NASD MediaSource, P.O. Box 9403, Gaithersburg, MD 20898-9403; to order with a credit card (American Express, MasterCard, or Visa), call (240) 386-4200, Monday to Friday, 9 a.m. to 5 p.m., Eastern Time. Back issues may be ordered by calling MediaSource at (240) 386-4200. Subscribers with subscription problems may contact NASD Corporate Communications at [gina.cherry@nasd.com](mailto:gina.cherry@nasd.com). To make an address change, please contact NASD's CRD Department at (301) 590-6500, or log on to the NASD Contact System at [http://www.nasdr.com/ncs.asp#NCS\\_Access](http://www.nasdr.com/ncs.asp#NCS_Access).

*Notices to Members* (December 1996 to current) are also available on the Internet at [www.nasd.com](http://www.nasd.com).

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Executive Representatives  
Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

OATS  
Rule 6950 Series

## GUIDANCE

### OATS Reporting Requirements

Mandatory Use of Combined New Order/Route and Combined New Order/Execution Reports Delayed until April 4, 2005; Clarification of Combined Reporting Format Requirements for Related Order Information Submitted by Multiple Order Sending Organizations

#### Executive Summary

In *Notice to Members* (NtM) 04-46 (June 2004), NASD announced that, beginning December 1, 2004, members would be required to use the Combined New Order/Route and Combined New Order/Execution Reports (Combined Reports) for all orders that are fully routed or executed on the same business day they are received. Based on feedback from firms, NASD is delaying the effective date of this requirement until April 4, 2005, to allow firms additional time to make necessary program and code changes. This delay applies only to the use of the Combined Reports and does not affect any of the other reporting changes and related implementation dates outlined in NtM 04-46.

In addition, NASD is clarifying that the Combined Reports format will not be mandatory in the limited circumstance where a firm uses multiple Order Sending Organizations (OSOs) to report order events relating to the same order (e.g., OSO A submits a New Order Report and OSO B submits a Route Report).

#### Questions/Further Information

Questions concerning this *Notice* may be directed to:

- ◆ OATS Helpdesk (800) 321-NASD
- ◆ NASD Market Regulation (240) 386-5126

---

## Background and Discussion

### **Mandatory Use of Combined Reports Delayed Until April 4, 2005**

Based on feedback from members and reporting agents relating to the significant programming changes necessary to implement the Combined Reports format, NASD is delaying the implementation date of the mandatory use of these reports for orders that are fully routed or executed on the same business day they are received until April 4, 2005. Specifically, members noted that use of the Combined Reports requires additional programming efforts because some firms use different systems to capture and report the various events in the lifecycle of the order. Therefore, additional time was needed to ensure that the data from each of these systems could be accurately combined and reported to OATS in a single report format. Accordingly, NASD is delaying the implementation date of this requirement until April 4, 2005.

### **Related Order Information Reported by Multiple OSOs**

Based on discussions with members and reporting agents, NASD also is clarifying that the Combined Reports format will not be mandatory in the limited circumstance where a firm uses multiple OSOs to report order events relating to the same order. Specifically, in those situations in which one OSO will report a new order event and a second OSO will report the related subsequent route or execution events, the Combined Reports will not be required. For example, a firm receives an order through one OSO's system but uses a second OSO's system to route the order. If the New Order and related Route Report are generated and reported to OATS by two separate OSOs, the Combined Reports format would not be required. Similarly, a firm receives an order through its own internal system but uses a third-party OSO's system to route the order. If the New Order Report is generated and reported by the firm, while the Route Report is generated and reported by the third-party OSO, the Combined Reports format would not be required. In these limited circumstances, it would be unduly burdensome for each OSO to build the necessary interfaces to allow one OSO to capture, combine and report all required information to OATS. Accordingly, the Combined Reports are not mandatory under these circumstances, and firms may continue to use the separate New Order and Route and Execution Reports, as applicable.

NASD will be monitoring the source of each order event submission to identify when one OSO submits all related order events for an order and does not use the Combined Reports. Orders where all related order events are submitted by the same OSO must use the Combined Reports beginning April 4, 2005. As a result, a member that uses multiple internal systems to generate and report order events for the same order must use the Combined Reports, as applicable, because only one OSO (*i.e.*, the firm itself) is creating and submitting all order events. Likewise, NASD will monitor the submission of related order reports by different OSOs to ensure that the reporting arrangements fall within the limited circumstances delineated above. In this respect, firms should be able to provide documentation upon NASD request to confirm the existence of such reporting arrangements.

---

## Questions and Answers

Q1. What are the phase-in dates for the new requirements?

A1. Requirement	Phase-in Date
Addition of Cancel Timestamp and Canceled By Flag Fields to New Order and Combined New Order/Route Reports	October 4, 2004
Required population of Cancel information on New Order and Combined New Order/Route Reports for any order canceled within 60 seconds of order receipt	November 1, 2004
Required use of cancel fields on New Order and Combined New Order/Route Reports for any order fully canceled on the same day it was received	December 1, 2004
Required use of Combined New Order/Route and Combined New Order/Execution Reports for any order fully routed or executed on the same day it was received	April 4, 2005

Q2. My firm has two separate OSOs submitting data on my behalf. One submits my New Order Reports and one submits my Route Reports. Is my firm required to use the Combined New Order/Route Report as of April 4, 2005?

A2. No. Since your firm is using two separate entities to submit the New Order and Route Reports respectively, the Combined New Order/Route Report is not mandatory and your firm may continue to use the separate New Order and Route Reports in these circumstances.

Q3. My firm uses two internal systems. We receive the order through one system and execute the order through the second system. Since we are using two separate systems, is my firm required to use the Combined New Order/Execution Report as of April 4, 2005?

A3. Yes. Since these systems are internal to your firm and your firm reports both events to OATS, you are required to use the Combined New Order/Execution Report by April 4, 2005.

- 
- Q4.** My firm receives orders through an internal system and routes them out through a service bureau's system. We generate and report New Order Reports to OATS while the service bureau reports the firm's Route Reports. Are we required to use the Combined New Order/Route Report by April 4, 2005?
- A4.** No. Your firm would not be required to use the Combined New Order/Route Report for those new order and route order events generated and reported separately by the firm and the service bureau.
- Q5.** My firm both receives and routes orders via a single service bureau's system that reports to OATS on my behalf. Is my firm required to use the Combined Reports by April 4, 2005?
- A5.** Yes. Since the receipt and route of the order is reported by the same entity, your firm would be required to use the Combined New Order/Route Report by April 4, 2005.
- Q6.** If my firm receives an order for 20,000 shares in an internal system and then routes it out 1,000 shares at a time via the same system, is my firm required to use the Combined New Order/Route Report for these orders by April 4, 2005?
- A6.** No. Since the order is not routed in its entirety, you must use the New Order Report to show receipt of the order and separate Route Reports for each partial route.

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

# Notice to Members

OCTOBER 2004

INFORMATIONAL

## SUGGESTED ROUTING

Executive Representatives  
Senior Management

## Nominees for NASD Board of Governors

## KEY TOPICS

NASD Board of Governors

### Executive Summary

The Annual Meeting of NASD members will be held on January 4, 2005.

The formal notice of the meeting, including the precise date, time, and location of the Annual Meeting, will be mailed on or about November 29, 2004.

The individuals nominated by the NASD National Nominating Committee (NNC) for election to the NASD Board of Governors (NASD Board) are identified in this *Special Notice*. Pursuant to Article VII, Section 10, of the NASD By-Laws, a person who has not been so nominated for election to the Board of Governors may be included on the ballot for the election of Governors if:

(a) within 45 days after the date of this *Special Notice*, such person presents to the Secretary of NASD petitions in support of such nomination duly executed by at least 3 percent of the members of NASD. As of the date of this *Special Notice*, NASD has 5,271 voting members; therefore, the applicable 3 percent threshold is 158 members. If, however, a candidate's name appears on a slate of nominees, the slate must be endorsed by 10 percent of NASD's voting members. The applicable 10 percent threshold is 527 members; and

---

(b) the Secretary certifies that such petitions have been duly executed by the Executive Representatives of the requisite number of members of NASD, and the person being nominated satisfies the classification of the governorship to be filled based on the information provided by the person as is reasonably necessary for the Secretary to make the certification.

Pursuant to Article VII, Section 4, of the NASD By-Laws, the NASD Board must consist of no fewer than 17 and no more than 27 Governors. The number of Governors within this range is set by the NASD Board. The Board is currently composed of 21 Governors.

On January 4, 2005, members will elect seven Governors, four of whom will occupy Industry positions on the Board, and three of whom will occupy Public positions on the Board.

### Questions/Further Information

Questions regarding this *Special Notice* may be directed to:

Barbara Z. Sweeney  
Senior Vice President and Corporate Secretary  
NASD  
1735 K Street, NW  
Washington, DC 20006-1500  
(202) 728-8062

**or**

T. Grant Callery  
Executive Vice President and General Counsel  
NASD  
1735 K Street, NW  
Washington, DC 20006-1500  
(202) 728-8285

---

## NASD Board of Governors Nominees

The following seven persons (see attached profiles) have been nominated by the NNC to serve on the Board of Governors of NASD for a term of three years or until their successors are duly elected or qualified. Terms of office run from January 4, 2005, to January 2008.

### Terms of Office 2005-2008

#### INDUSTRY

John W. Bachmann	Managing Partner, Edward D. Jones & Company
Richard F. Brueckner	Chief Executive Officer, Pershing LLC (Representative of a Firm that Provides Clearing Services to other NASD Members)
William Heyman	Executive Vice President and Chief Investment Officer, The St. Paul Travelers Companies, Inc. (Representative of an Insurance Company)
Raymond A. Mason	Chairman and CEO, Legg Mason, Inc. (Representative of a Regional Retail or Independent Financial Planning Member Firm)

#### PUBLIC

James E. Burton	Chief Executive Officer, World Gold Council
Sir Brian Corby	Chairman (retired), Prudential Assurance Company
John Rutherford, Jr.	Chairman and CEO, Moody's Corporation

## NASD Profiles of Board Nominees for Industry Governors

#### INDUSTRY

**John W. Bachmann** is managing partner of Edward Jones. Mr. Bachmann has been with Edward Jones in various positions since 1959. He became managing principal in 1980. Mr. Bachmann served as Chairman of the Securities Industry Association and on the Board of Governors of the Chicago Stock Exchange and on the Regional Firm's Advisory Board of the New York Stock Exchange. He has also served as Chairman of the NASD District 4 Committee. He holds a degree in economics from Wabash College and a Master's in finance from Northwestern University.

---

**Richard F. Brueckner** is Chief Executive Officer of Pershing LLC, a wholly owned subsidiary of The Bank of New York (BNY). Mr. Brueckner joined BNY in May 2003 when BNY acquired Pershing from Credit Suisse First Boston. He served as CEO of Pershing and as a member of the CSFB Executive Board after CSFB's acquisition of Donaldson, Lufkin and Jenrette and Pershing in November 2000. Mr. Brueckner joined DLJ in 1978 and has served as Treasurer of DLJ Securities Corporation, Chief Financial Officer of Pershing, and has held a variety of senior management positions in administration, finance, marketing, and operations at Pershing. Prior to 1978, he was in the management group of the Investment Services Department of KPMG Peat Marwick. Mr. Brueckner served as Chairman of the Securities Industry Foundation for Economic Education and is a trustee of its successor organization, Foundation for Investor Education. He is a director of the Securities Industry Association and has served as the founding Chairman of the Clearing Firms Committee, Chairman of the Membership Committee, and Chairman of the New York District. He has also served on various boards and committees for NASD. Mr. Brueckner holds a B.A. in economics from Muhlenberg College, where he is Vice Chairman of the Board of Trustees. He is also a CPA.

**William Heyman** is Executive Vice President and Chief Investment Officer of The St. Paul Travelers Companies, Inc. Until March 15, 2002, Mr. Heyman was Chairman of Citigroup Investments, a subsidiary of Citigroup that managed most of Citigroup's proprietary investments. His responsibilities included all public and private equity-related investments, real estate and alternative investments, as well as Citigroup's pension fund. He founded and was, until his departure, Chief Executive Officer of Tribeca Investments, a Citigroup subsidiary that conducts proprietary trading and investment activities including merger arbitrage and convertible hedging. He was a Senior Vice President of various Citigroup insurance subsidiaries, including Travelers, and served as a Citigroup representative on several boards. Prior to joining Citigroup in 1995, he was, successively, a managing director and head of the private investment department of Solomon Brothers; director of the Division of Market Regulation of the U.S. Securities and Exchange Commission in Washington, DC (1991-1993); and a managing director and head of the arbitrage department of Smith Barney. He began his career in the securities business in 1979, when he co-founded Mercury Securities, a broker-dealer specializing in merger arbitrage of which he was the Chief Operating Officer for nine years. Prior to that, he was a securities lawyer, principally with Cravath, Swaine & Moore. Mr. Heyman graduated *magna cum laude* from Princeton University, where he was elected to Phi Beta Kappa, and *cum laude* from Harvard Law School.

---

**Raymond A. Mason** is Chairman of the Board, President, and Chief Executive Officer of Legg Mason, Inc., and Chairman and CEO of Legg Mason Wood Walker, Inc. Mr. Mason founded Mason and Company in 1962, and in 1970 the company merged to form Legg Mason, Inc. He has been very active in the securities industry, serving as Chairman of the Securities Industry Association in 1986, Chairman of the Board of Governors of NASD in 1974, and Chairman of the Regional Firms Committee of the New York Stock Exchange in 1978. He was appointed by the SEC to serve on a broker compensation practices committee in May 1994. Currently, he is Chairman of the Board of Trustees of Johns Hopkins University and a member of the executive committee of both Johns Hopkins University and Johns Hopkins Medicine, and Chairman of the Maryland Business Roundtable for Education. Mr. Mason received a bachelor's degree in Economics from the College of William and Mary.

## NASD Profiles of Board Nominees for Public Governors

### PUBLIC

**James E. Burton** is the Chief Executive Officer of World Gold Council in London, England. Previously, he served as Chief Executive Officer of California Public Employees Retirement System (CalPERS) since 1994. Prior to joining CalPERS, Mr. Burton was Deputy State Controller, advising the State Controller on public pension, government borrowing and other state finance issues. He has also held various government positions, including Deputy Chief of Staff to Governor Jerry Brown. Currently, Mr. Burton is Second Vice President and a member of the Executive Committee of the National Association of State Retirement Administrators, and Co-Chair of the Council of Institutional Investors. Mr. Burton holds a degree from the University of San Francisco.

**Sir Brian Corby** served as Chairman of Prudential Corporation from 1990 until his retirement in 1995. Prior to this, he was Group Chief Executive. Sir Brian has also served as President of the Confederation of British Industry, President of the National Institute of Economic and Social Research, and President of the "Association de Geneve," an insurance industry "think tank." He was made a Knight Bachelor in the Queen's Birthday Honours in June 1989. Sir Brian graduated with an honours degree in mathematics from St. John's College Cambridge.

---

**John Rutherford, Jr.** is Chairman and Chief Executive Officer of Moody's Corporation. He was elected Chairman in October 2003. Mr. Rutherford was named CEO when the firm became an independent public company in October 2000. Previously, Moody's was part of the Dun & Bradstreet Corporation. He joined the company in 1995 to develop new business activities with the title of Managing Director, Moody's Holdings. He was appointed Chief Administrative Officer in 1996 and President in 1998. Prior to joining Moody's, he was President of Interactive Data Corporation (IDC) from 1990 to 1995, Executive Vice President of Dun & Bradstreet Financial Information Services (North America) from 1989 to 1990, and Vice President and Chief of Staff from 1980 to 1985 of Chase Information Services Group, an affiliate of Chase Manhattan Bank. Mr. Rutherford received an AB from Princeton University and an LLB from Harvard Law School.

## Governors with Terms Expiring in January 2005

### INDUSTRY

John W. Bachmann	Managing Partner, Edward D. Jones & Company
Richard F. Brueckner	Chief Executive Officer, Pershing LLC (Representative of a Firm that Provides Clearing Services to other NASD Members)
Raymond A. Mason	Chairman and CEO, Legg Mason, Inc. (Representative of a Regional Retail or Independent Financial Planning Member Firm)
Barbara L. Weaver <sup>1</sup>	Vice President, Legal & Compliance, Howard Weil, Incorporated (Chair of the National Adjudicatory Council)

### NON-INDUSTRY

Harry P. Kamen*	Retired Chairman and Chief Executive Officer, Metropolitan Life Insurance Company (Representative of an Insurance Company)
-----------------	--

### PUBLIC

James E. Burton	Chief Executive Officer, World Gold Council
Sir Brian Corby	Chairman (retired), Prudential Assurance Company
John Rutherford, Jr.	President and CEO, Moody's Corporation

\* Not eligible for re-election

---

## Governors with Terms Expiring in January 2006

### INDUSTRY

David A. DeMuro Managing Director, Director of Global Compliance and Regulation, Lehman Brothers, Inc. (Representative of a National Retail Firm)

M. LaRae Bakerink\* Chief Executive Officer, Westfield Bakerink Brozak, LLC

### NON-INDUSTRY

John J. Brennan Chairman and CEO, The Vanguard Group (Representative of an Issuer of Investment Company Shares or an Affiliate of such an Issuer)

Eugene M. Isenberg\* Chairman and CEO, Nabors Industries, Inc.

### PUBLIC

Kenneth M. Duberstein\* Chairman and CEO, The Duberstein Group, Inc.

\* Not eligible for re-election

## Governors with Terms Expiring in January 2007

### INDUSTRY

William C. Alsover, Jr.\* Chairman, Centennial Securities Company, Inc. (Representative of an NASD Member having not more than 150 Registered Persons)

### PUBLIC

Charles A. Bowsher Former Comptroller General of the United States

Joel Seligman Dean, Washington University School of Law

Sharon P. Smith\* Dean, College of Business Administration, Fordham University

\* Not eligible for re-election

---

## Endnote

- 1 The Chair of the National Adjudicatory Council serves a one-year term on the NASD Board.

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registered Representatives  
Senior Management  
Trading

## KEY TOPICS

Account Name/Designation Changes  
CEO Certification  
Holding Customer Mail  
IM-3110 (Customer Account Information)  
Rule 2510 (Discretionary Accounts)  
Rule 3010 (Supervision)  
Rule 3012 (Supervisory Control Systems)  
Rule 3013 (Annual Certification of Compliance and Supervisory Processes)  
Rule 3110 (Books and Records)  
Supervision  
Supervisory Control Procedures  
Time and Price Discretion

## GUIDANCE

### Supervisory Controls

SEC Approves New Rules and Rule Amendments Concerning Supervision and Supervisory Controls;  
**Effective Date: January 31, 2005**

#### Executive Summary

On June 17, 2004, the Securities and Exchange Commission (SEC) approved rule changes (Supervisory Control Amendments) by NASD that both create and amend certain rules and interpretive materials to address a member's supervisory and supervisory control procedures.<sup>1</sup> On September 30, 2004, the SEC granted accelerated approval to proposed rule changes to the Supervisory Control Amendments to conform certain parts of the new rule requirements to the New York Stock Exchange's (NYSE's) recently approved internal control amendments.<sup>2</sup> In their entirety, the approved rule changes:

- ◆ Eliminate Rule 3010(a)(8), which required a member to identify one or more principals who will review the member's supervisory system, procedures, and inspections and take or recommend action to achieve the member's compliance with applicable securities laws and regulations and with NASD rules;
- ◆ Create Rule 3012 to require a member to designate one or more principals who will establish, maintain, and enforce a system of supervisory control policies and procedures that test and verify that the member's supervisory procedures are reasonably designed to comply with applicable securities laws and NASD rules and amend those supervisory procedures where necessary. Rule 3012 also requires that a person senior or "otherwise independent" to a producing manager perform the day-to-day supervisory reviews of the producing manager's account activity. However, if a member is so limited in size and resources that it cannot

---

comply with this general supervisory requirement, the member may have a knowledgeable principal perform the supervisory reviews. In addition, a member must have in place heightened supervisory procedures for the supervision of a producing manager who is responsible for 20 percent or more of the revenue generated by the business units supervised by the producing manager's supervisor.

- ▶ Amend Rule 3010(c) to codify the minimum inspection cycles for a member's offices and to require that office inspections include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures in certain specified areas. There is a general requirement that an office inspection may not be conducted by the branch office manager for that office, any person within that office who has supervisory responsibilities, or any individual who is directly or indirectly supervised by such persons. However, if a member is so limited in size and resources that it cannot comply with this limitation, the member may have a knowledgeable principal perform the inspections. Depending upon the position of the person within the member who conducts the inspection, a member must have in place heightened inspection procedures for the inspection of an office where the producing manager is responsible for 20 percent or more of the revenue generated by the business units supervised by the producing manager's supervisor.
- ▶ Amend Rule 3110 to require that before any customer order is executed, the account name/designation must be placed upon the memorandum for each transaction. Additionally, no changes to the account name/designation can be made unless previously authorized by a member or a person designated under NASD rules (who must pass a qualifying principal exam). Such person, prior to giving such approval, must be informed of the essential facts and indicate his/her approval in writing on the order or similar record. The facts relied upon by the person in approving the change must be documented in writing and preserved for a period of not less than three years, with the documentation preserved for the first two years in an easily accessible place, as the term "easily accessible place" is used in SEC Rule 17a-4.
- ▶ Amend Rule 2510(d)(1) to require that time and price discretionary authority is limited to the day it is granted, absent a specific, written indication signed and dated by the customer. The limitation does not apply to time and price discretion exercised for orders in an institutional account pursuant to valid Good-Till-Cancelled instructions issued on a "not held" basis. Any exercise of time and price discretion must be reflected on the order ticket.

This *Notice* provides interpretive guidance on these rule changes. The *Notice* also explains the relationship between recently approved (but not yet effective) Rule 3013 and Rules 3012 and 3010. The text of the amendments is set forth in Attachment A and becomes effective on **January 31, 2005**.<sup>3</sup> A table of contents has been provided for readers' convenience.

---

## Questions/Further Information

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

## SUPERVISORY CONTROL AMENDMENTS

### Table of Contents

<b>Background</b>	<b>826</b>
<b>Relationship between Rules 3010, 3012, and 3013</b>	<b>826</b>
<b>Rule 3012 (Supervisory Controls System)</b>	<b>827</b>
Testing and Verification of a Member’s Supervisory Procedures	827
Senior or “Otherwise Independent” Person to Review Producing Manager	827
Heightened Supervision Requirements	828
“Limited Size and Resources” Exception	829
Future Notice Requirement for Exception Users	831
Activities that Require Individualized Policies and Procedures	831
Dual Members’ Compliance with Substantially Similar NYSE Requirements	832
Elimination of Rule 3010(a)(8)	832
<b>Rule 3010 (Supervision)</b>	<b>832</b>
Mandatory Inspection Cycles	832
Required Content and Recordkeeping Requirements for Inspection Reports	834
“Limited Size and Resources” Exception	834
Heightened Inspection Requirements	835
<b>Rule 3110 (Books and Records)</b>	<b>836</b>
Approval and Documentation Procedures for Changes in Account Name/Designation	836
<b>IM-3110 (Customer Account Information)</b>	<b>837</b>
Time Limits for Holding Customer Mail	837
<b>Rule 2510 (Discretionary Accounts)</b>	<b>838</b>
One-Day Limit on Time/Price Discretionary Authority	838

---

## Background

Adequate supervisory systems play an important role in assuring investor protection and the integrity of the markets. Operational and sales practice abuses can stem from ineffective supervisory and supervisory control procedures. The 2002 Gruttadauria case, which involved a branch office manager's misappropriation of approximately \$40 million of customer funds,<sup>4</sup> brought tremendous attention to the ongoing problem of operational and sales practice abuses at firms and the importance of ensuring that firms effectively monitor the activities of their employees.

In light of the concerns raised by the Gruttadauria case with respect to inadequate supervisory systems, NASD has amended certain rules and interpretive materials and has created new Rule 3012 (Supervisory Controls System). This *Notice* explains and describes those amendments and the provisions of Rule 3012. This *Notice* also explains how recently approved Rule 3013 (Annual Certification of Compliance and Supervisory Processes) and IM-3013 (Annual Compliance and Supervision Certification) interact with Rule 3012 and amended Rule 3010 (Supervision).

## Relationship between Rules 3010, 3012, and 3013

New Rule 3013 requires each member firm's chief executive officer (CEO) to certify annually that senior executive management has in place processes to: (1) establish, maintain, and review policies and procedures reasonably designed to achieve compliance with applicable NASD rules, Municipal Securities Rulemaking Board (MSRB) rules, and federal securities laws and regulations; (2) modify such policies and procedures as business, regulatory, and legislative changes and events dictate; and (3) test the effectiveness of such policies and procedures on a periodic basis, the timing of which is reasonably designed to ensure continuing compliance with NASD rules, MSRB rules, and federal securities laws and regulations. IM-3013 sets forth the language of the CEO certification and gives further guidance as to the requirements and limitations of Rule 3013.

Because Rules 3010 and 3012 also address a member firm's supervisory policies and procedures, firms have questioned whether these rules impose duplicative requirements regarding the establishment of a firm's supervisory policies and procedures. Although Rules 3010, 3012, and 3013 are closely related, their obligations are complementary, not duplicative, in nature. The three rules essentially come together to form an overarching regulatory scheme for the supervision of member firms. First, Rule 3013 requires the CEO of each member to certify that they have a *process* to adopt compliance policies and supervisory procedures reasonably designed to achieve compliance with applicable securities laws and regulations and NASD rules. Rule 3010 requires the establishment of a supervisory system for the firm's business activities, including the adoption of policies and procedures reasonably designed to achieve compliance with applicable securities laws and regulations and NASD rules. The establishment of the supervisory system required to be adopted in Rule 3010 should result from the processes that are the subject of the certification of Rule 3013. Finally, Rule 3012 requires firms to (i) have

---

supervisory control procedures that test and verify that the members' supervisory procedures are reasonably designed to achieve compliance with applicable securities laws and regulations and NASD rules, and (ii) where necessary, amend or create additional supervisory procedures. In sum, NASD's new regulatory supervisory scheme consists of process, supervision, and adoption of policies and procedures,<sup>5</sup> and testing and amendment of such policies and procedures.

## Rule 3012 – Supervisory Control System

### Testing and Verification of a Member's Supervisory Procedures

New Rule 3012 requires that a member designate and specifically identify one or more principals who will establish, maintain, and enforce supervisory control procedures that will test and verify that the member's supervisory procedures are sufficient and amend or create additional supervisory procedures where the need is identified by such testing and verification.<sup>6</sup> Of course, NASD expects that the designated principals will test and verify the adequacy of the supervisory control procedures in a manner that is independent of any business considerations that are countervailing to full compliance with applicable securities laws and regulations and NASD rules.

### Senior or "Otherwise Independent" Person to Review Producing Manager

Rule 3012's supervisory control policies and procedures must include procedures that are reasonably designed to review and supervise on a day-to-day basis the customer account activity conducted by the member's branch office managers, sales managers, regional or district sales managers, or any person performing a similar supervisory function.<sup>7</sup> A person who is senior to or "otherwise independent" of the producing manager must perform these day-to-day supervisory reviews.<sup>8</sup> An associated person is considered a producing manager regardless of the amount of customer account activity the producing manager conducts. Accordingly, if the president of a member firm manages only a few accounts on behalf of the president's family and friends, that person is considered a producing manager for purposes of Rule 3012.

NASD understands that the determination of seniority for the purpose of deciding who should conduct a producing manager's supervisory reviews is a facts and circumstances test. A person who does not report to the producing manager, whose compensation is not determined in whole or part by the producing manager, and who is not in the same chain of authority may be considered senior to the producing manager if that person has the authority to oversee, direct, and correct the activities of the producing manager and take all necessary remedial actions, including termination, if and when necessary.

Similarly, a member must consider certain factors in determining whether a person is an "otherwise independent" person for purposes of conducting a producing manager's day-to-day supervisory reviews. An "otherwise independent" person who may conduct supervisory reviews may not report either directly or indirectly to the producing

---

manager under review. In addition, the otherwise independent person must be situated in an office other than the office of the producing manager, must not otherwise have supervisory responsibility over the activity being reviewed (including not being directly compensated based in whole or in part on the revenues accruing from those activities), and must alternate such review responsibility with another qualified person every two years or less.<sup>9</sup>

The ability of member firms to use individuals who are either senior to or “otherwise independent” of the producing manager to conduct the producing manager’s day-to-day supervisory reviews allows member firms the flexibility to structure their supervisory review policies and procedures in a manner that both accords with their various business models and achieves the best customer protection practices. For example, if a member firm has a person who is senior to the producing manager assigned as the producing manager’s supervisor but determines that, for customer protection purposes, the producing manager’s supervisor should not conduct the day-to-day supervisory reviews of the producing manager’s customer account activity because the supervisor is located in the producing manager’s office, the member firm may have a person who meets the definition of an “otherwise independent” person conduct the day-to-day supervisory reviews of the producing manager’s customer account activity.

### **Heightened Supervision Requirements**

In addition, Rule 3012’s supervisory control policies and procedures require a member to have procedures that are reasonably designed to provide heightened supervision over the activities of the producing manager if the producing manager is responsible for generating 20 percent or more of the revenue of the business units supervised by the producing manager’s supervisor over the course of a rolling, twelve-month period.<sup>10</sup> NASD views this 20 percent threshold as a trigger for determining when a member must put in place heightened supervisory procedures. For purposes of determining the 20 percent threshold, a member must look at all revenue generated by or credited to the producing manager or the producing manager’s office, and that amount shall be included as part of the overall revenues of the business units supervised by the producing manager’s supervisor irrespective of a member’s internal allocation of such revenue. Rule 3012 requires the 20 percent threshold to be calculated on a rolling, twelve-month basis. The standard for heightened supervision in Rule 3012 does not create a negative safe harbor, *i.e.*, the inspection of offices falling below the 20 percent threshold does not create a presumption that heightened supervision is not required. A member may need to employ heightened supervision in connection with reviews based on other facts and circumstances.

For purposes of Rule 3012, the term “heightened supervision” means those supervisory procedures that are designed to avoid conflicts of interest that serve to undermine complete and effective supervision because of the economic, commercial, or financial interests that the supervisor holds in the associated persons and businesses being supervised.<sup>11</sup> Heightened supervisory procedures may include such elements as unannounced supervisory reviews, an increased number of supervisory reviews by

---

different reviewers within a certain period, a broader scope of activities reviewed, and/or having one or more principals approve the supervisory review of such producing managers. These examples are meant to illustrate the type of procedures a member may want to include in its heightened supervisory procedures and are not meant to be an exclusive or exhaustive list of heightened supervisory procedures a member may need to put in place.

Member firms should note that an “otherwise independent” person is not considered to be the producing manager’s supervisor for purposes of determining whether a producing manager is responsible for generating 20 percent or more of the revenue of the business units supervised by the producing manager’s supervisor, such that the member firm must put in place heightened supervisory procedures. Accordingly, if an “otherwise independent” person conducts a producing manager’s supervisory reviews, the firm will not be required to put in place heightened supervisory procedures. The heightened supervision requirement is designed to avoid any conflicts of interest that may undermine an objective and comprehensive review of the producing manager’s customer activity. The factors that define an “otherwise independent” person already protect against the possibility that any conflicts of interest may exist that might adversely affect the producing manager’s supervisory reviews, especially the restriction that an “otherwise independent” person not be directly compensated based in whole or in part on the revenues accruing from the activities being reviewed.

#### **“Limited Size and Resources” Exception**

Rule 3012 provides a limited exception for any member firm that is so limited in size and resources (the “limited size and resources” exception) that the member does not have associated persons who can conduct supervisions and are senior or “otherwise independent” from the producing managers. In such situations, a member may have the reviews conducted by a principal who is sufficiently knowledgeable of the member’s supervisory control procedures.<sup>12</sup> Whether a member firm may use the “limited size and resources” exception depends on the facts and circumstances surrounding each member firm. In some instances, the size of a member firm will generally determine that the member firm does not have the ability to conduct the supervisory reviews for any of its producing managers. For example, a sole proprietor or a member with only one small office will be eligible to use the “limited size and resources” exception.

In other instances, a member may be able to use the “limited size and resources” exception for part, but not all, of its supervisory obligations. For example, a member firm may have the size and resources to have a person senior or “otherwise independent” conduct the reviews of the branch manager of each office but may need to use the exception in connection with the supervision of the customer account activity of producing supervisors up the chain of command up to and including the CEO. Nevertheless, members should be mindful that they can avail themselves of the “limited size and resources” exception only where a person senior or “otherwise independent” of the producing manager is not available to conduct supervision of the producing manager’s customer account activity. Having someone available but who may

---

find it difficult to conduct the supervisory reviews is not sufficient to use the “limited size and resources” exception. Members that do qualify to use the exception may, nevertheless, want to consider whether it would be in the best interests of the firm to prohibit its senior persons from servicing accounts.

Because the “limited size and resources” exception is designed for those firms that genuinely need relief from the general supervisory requirement applicable to producing managers, NASD expects the “limited size and resources” exception to be narrowly construed. Moreover, there is no initial allowance (as discussed below in the context of Rule 3010) for any particular business model to be permitted to be deemed of “limited size and resources” solely because of its business model. As noted further below, each firm using the exception, regardless of business model, will need to evidence its being of such “limited size and resources” that it cannot comply with the general requirement. Firms that either construct their business models specifically to take advantage of the “limited size and resources” exception or that have the size and resources to comply with the general requirement and yet fail to comply with the general requirement will be in violation of Rule 3012.

Any supervisory reviews conducted using the “limited size and resources” exception must still comply, to the extent possible with the general requirement, that someone who is either senior or “otherwise independent” conduct the reviews.<sup>13</sup> For example, if a firm does not have someone who is senior to a producing manager but does have persons who would be considered “otherwise independent” except for the fact that there is an insufficient number to meet the requirement that they conduct the supervisory reviews on a two-year rotation, the member firm must use these qualified persons to conduct the producing manager’s supervisory reviews rather than using a principal who is sufficiently knowledgeable of the member firm’s supervisory control procedures but who does not meet the factors of the “otherwise independent” definition.

A member using the “limited size and resources” exception must also document in its supervisory control procedures the factors used to determine that complete compliance with all of the provisions of the general supervisory requirement is not possible and that the required supervisory system and procedures in place with respect to any producing manager comply, to the extent practicable, with the general supervisory requirement.<sup>14</sup> For instance, a member firm using the “limited size and resources” exception to conduct the day-to-day supervisory reviews of its most senior personnel who are also considered producing managers but that has the resources to use the general supervisory requirement to conduct the day-to-day supervisory reviews of the rest of its producing managers, must document factors, such as the lack of sufficiently qualified personnel to conduct supervisory reviews of its senior persons, and how, to the extent practicable, the persons who are conducting the senior persons’ supervisory reviews meet some, if not all, of the provisions of the “otherwise independent” definition.

---

### **Future Notice Requirement for Exception Users**

The SEC has specified in the Approval Order that NASD must notify the SEC of those members that elect to use Rule 3012's "limited size and resources" exception to the general supervisory requirement applicable to producing managers. Accordingly, member firms should be aware that NASD plans to file a rule change to require in the future that firms using the "limited size and resources" exception notify NASD of their use of the exception. NASD believes it is essential to collect this information from members using a Web-based reporting system or other automated electronic platform. Accordingly, it is intended that the reporting requirement effective date will coincide with the completion of an electronic reporting process and system designed for that purpose. Initial technology estimates indicate that it should take no more than one year from the date of the Approval Order to construct this Web-based system (or other electronic platform) and bring it on-line; however, members should be aware that NASD will need to bring such system on-line as soon as practicable.

### **Activities that Require Individualized Policies and Procedures**

Rule 3012 also requires that a firm's supervisory control policies and procedures include procedures that are reasonably designed to review and monitor the following activities:

- ▶ All transmittals of funds (e.g., wires or checks, etc.) or securities—
  - From customers and third-party accounts (e.g., a transmittal that would result in a change of beneficial ownership);
  - From customer accounts to outside entities (e.g., banks, investment companies, etc.);
  - From customer accounts to locations other than a customer's primary residence (e.g., post office box, "in care of" accounts, alternate address, etc.); and
  - Between customers and registered representatives, including the hand-delivery of checks.
- ▶ Customer changes of address and the validation of such changes of address; and
- ▶ Customer changes of investment objectives and the validation of such changes of investment objectives.<sup>15</sup>

Members should note that the policies and procedures for monitoring these activities must include a means or method of customer confirmation, notification, or follow-up that can be documented.<sup>16</sup> NASD does not expect a member to have in place supervisory policies and procedures for activities in which it does not engage. However, a member must identify those activities in which it does not engage in its written supervisory control policies and procedures and document that additional supervisory policies and procedures for such activities must be in place before a member can engage in them.<sup>17</sup>

---

### **Dual Members' Compliance with Substantially Similar NYSE Requirements**

Rule 3012 also provides that any member in compliance with substantially similar requirements of the NYSE shall be deemed to be in compliance with Rule 3012.<sup>18</sup> NASD believes that this provision helps promote consistency between NASD's and the NYSE's supervisory control requirements.

### **Elimination of Rule 3010(a)(8)**

Finally, NASD has eliminated Rule 3010(a)(8), which required a member to identify one or more principals who will review the member's supervisory system, procedures, and inspections and take or recommend action to achieve the member's compliance with the applicable securities laws and regulations and with NASD rules. In light of Rule 3012's requirements, NASD believes that retaining Rule 3010(a)(8) could result in members having to engage in duplicative efforts to meet both rules' provisions.

## **Rule 3010 – Supervision**

### **Mandatory Inspection Cycles**

Amended Rule 3010(c)(1) details mandatory inspection cycles that each member must have in place for its supervisory branch offices, non-supervisory branch offices, and unregistered locations. NASD believes that codifying these mandatory inspection schedules will enhance oversight and supervision of branch and non-branch locations.

Specifically, Rule 3010(c)(1) requires each member to inspect, at least annually, each supervisory branch office.<sup>19</sup> Any location that is responsible for supervising the activities of persons associated with a member at one or more of a member's non-branch office locations is considered to be a branch office.<sup>20</sup> This codifies previous NASD guidance that branch offices that supervise one or more locations must be inspected at least annually.<sup>21</sup>

Also, Rule 3010(c)(1) requires a member to inspect all non-supervisory branch offices, at a minimum, every three years.<sup>22</sup> When establishing how often to inspect its non-supervisory branch offices, the member must consider whether the nature and complexity of a branch office's securities activities, the branch office's volume of business, and the number of associated persons assigned to the branch office require inspections more frequently than every three years. Also, a member must set forth in its written supervisory and inspection procedures the examination cycle and an explanation of the factors the member used in determining the frequency of the cycle.<sup>23</sup> These requirements are consistent with previous NASD guidance advising that, in determining the inspection cycle for a non-supervisory branch office, a member should consider the nature and complexity of the securities activity for which the branch office is responsible, as well as the volume of business conducted at the office and the number of associated persons assigned to the office and that, after determining the inspection cycle, a member should document the cycle in its written supervisory and inspection procedures.<sup>24</sup>

---

NASD understands that a general practice exists where a member may inspect non-supervisory branch offices on a more frequent cycle than once every three years but target only certain areas of the offices' activities during a particular examination. Accordingly, Rule 3010(c)(1) requires that a member following this practice must inspect all of the required areas listed in Rule 3010(c)(2), which are discussed below, within the three-year cycle, regardless of the number of times within that cycle a non-supervisory branch office is inspected. Also, a member must set forth in its written supervisory and inspection procedures the manner in which it will inspect those areas within the three-year cycle.<sup>25</sup>

Additionally, Rule 3010(c)(1) requires a member to inspect every non-branch location on a regular periodic schedule.<sup>26</sup> In establishing the inspection schedule, a member must consider the nature and complexity of the location's securities activities and the nature and extent of contact with customers and set forth in its written supervisory and inspection procedures an explanation regarding how the member determined the frequency of the examination schedule.<sup>27</sup> These requirements are consistent with previous NASD guidance stating that non-branch locations should be inspected according to a regular schedule and that the frequency and scope of inspections should be determined based on factors such as the nature and volume of business conducted at the office and the nature and extent of contact with customers.<sup>28</sup>

Members are advised to look carefully at the activities of their non-branch locations to ensure that they are not considered by Rule 3010 to be a branch office. As previously noted, Rule 3010 considers a non-branch location to be a branch office if it is responsible for supervising the activities of persons associated with a member at one or more of the member's non-branch locations.<sup>29</sup>

Members should be advised that "locations of convenience" are, by definition, excluded from being a branch office and, consequently, fall under the category of a non-branch location.<sup>30</sup> A location of convenience is any location where a person conducts business on behalf of the member occasionally and exclusively by appointment for the customer's convenience.<sup>31</sup> Often, but not always, a location of convenience will be a branch office of a bank affiliated with the member firm. Sometimes, because the meeting is being arranged for the customer's convenience, the meeting place could be a hotel conference center or other public area that is close to the customer. No records of the business conducted are usually kept at this site because it is not considered a place within the member firm's purview. However, Rule 3010 would require that locations of convenience still be examined on a regular periodic schedule. If locations of convenience were excluded from the inspection requirement, it could be possible for an associated person to clandestinely conduct business at that location on a more routine basis, and perhaps to arrange to keep records of any business conducted at the location that the associated person would not want revealed to the member firm. As an aid in determining when to conduct such inspections, a member firm may want to require each associated person to record when a customer requests to meet at a location of convenience, where the location of convenience is situated, how often the associated person uses any location of convenience, and what kind of business is conducted at these locations of convenience.

---

### **Required Content and Recordkeeping Requirements for Inspection Reports**

Rule 3010(c)(2) mandates that a member must reduce each office inspection to a written report and keep it on file for a minimum of three years, unless the inspection is being conducted pursuant to a regular periodic cycle for non-branch office locations and the regular periodic schedule is longer than a three-year cycle, in which case the member must keep the report on file at least until the next inspection report has been written. The written inspection report must also include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures, in the areas of:

- ▶ Safeguarding customer funds and securities;
- ▶ Maintaining books and records;
- ▶ Supervising customer accounts serviced by branch office managers;
- ▶ Transmitting funds between customers and registered representatives and between customers and third parties;
- ▶ Validating customer address changes; and
- ▶ Validating changes in customer account information.<sup>32</sup>

NASD does not expect a member to have in place procedures for activities in which it does not engage. However, the member must identify those activities in which it does not engage in the written inspection report and document in the report that supervisory policies and procedures for such activities must be in place before the member can engage in them.<sup>33</sup>

### **"Limited Size and Resources" Exception**

Rule 3010(c)(3) prohibits a branch office manager or any person within that office who has supervisory responsibilities or any individual who is supervised by such persons from conducting office inspections. NASD understands, however, that members have different business models and/or are limited in size and resources such that they are not able to comply fully with those restrictions regarding who can conduct an office inspection.

Accordingly, Rule 3010(c)(3) also provides a "limited size and resources" exception for members that cannot comply with the general inspection requirement's restrictions on who may conduct an office inspection. Under the exception, a member firm may continue to use the persons they have previously used to conduct the office inspections provided they are principals and have the requisite knowledge to conduct such inspections.<sup>34</sup> Members, however, must be able to document in the office inspection reports that their size and resources are such that they have no other alternative.<sup>35</sup>

Whether a firm is so limited in its size and resources that it cannot comply with the general requirement is a facts and circumstances test and, similar to the "limited size and resources" exception in Rule 3012, should be narrowly construed. For instance,

---

although Rule 3010 provides as an example of limited size and resources, a member with only one office, this does not mean that any member with one physical location may use the “limited size and resources” exception. The example in the rule text is meant to illustrate a small member, such as a member with a single, three-person office. A member that has one physical location that includes a single production office, yet is so big that there are other departments, such as corporate offices, technology offices, etc., would be of sufficient size and resources such that there would be someone within the firm outside the production office that could conduct the inspection. However, **in the case of Rule 3010 only**, a member firm may use the exception regardless of its size and resources if the firm has a business model where small or single-person offices report directly to an OSJ manager who is also considered the offices’ branch office manager (also referred to as the “independent dealer or independent contractor model”).<sup>36</sup> Members with such business models should note that the exception does not apply on a business model basis to the inspection of the OSJ; whether an OSJ qualifies for the exception is based solely on a limitation of size and resources exclusive of business model considerations.

With the exception of those firms using the exception in Rule 3010 as a result of their business model (*i.e.*, those firms with the independent dealer model described above), members should be aware that the “limited size and resources” exception is designed for those firms that genuinely need relief from the general inspection requirement. Firms that either construct their business models specifically to take advantage of the “limited size and resources” exception or that have the size and resources to comply with the general inspection requirement and yet fail to comply with the general requirement will be in violation of Rule 3010.

### Heightened Inspection Requirements

Rule 3010(c)(3) also requires a member to have in place procedures that are reasonably designed to provide heightened office inspections if two conditions are met: (1) the person conducting the inspection reports to the branch office manager’s supervisor or works in an office supervised by the branch manager’s supervisor; and (2) the branch office manager generates 20 percent or more of the revenue of the business units supervised by the branch office manager’s supervisor. NASD views this 20 percent threshold as a trigger for determining when a member must put in place heightened inspection procedures. For purposes of determining the 20 percent threshold, a member must look at all revenue generated by or credited to the producing manager or the producing manager’s office, and that amount shall be included as part of the overall revenues of the business units supervised by the producing manager’s supervisor irrespective of a member’s internal allocation of revenues.<sup>37</sup> If a producing manager does not have an individual assigned to supervise him but, rather, is supervised directly by the member’s compliance department, then the revenue produced would be attributable to a business unit supervised by the compliance department. If such revenue constitutes 20 percent or more of all of the supervised revenue attributable to the compliance department, then the member must have in place heightened inspection procedures. Rule 3010 requires the 20 percent threshold to be calculated on a rolling, twelve-month basis.<sup>38</sup> As stated above in the discussion of Rule 3012, a

---

member may need to employ heightened office inspection procedures based on other facts and circumstances.

Rule 3010's term "heightened inspection" means those inspection procedures that are designed to avoid conflicts of interest that serve to undermine complete and effective inspection because of the economic, commercial, or financial interests that the branch manager's supervisor holds in the associated persons and businesses being inspected.<sup>39</sup> Heightened inspection procedures may include such elements as unannounced office inspections, increased frequency of inspections, a broader scope of activities inspected, and/or having one or more principals review and approve the office inspections. These examples are meant to illustrate the type of procedures a member may want to include in its heightened inspection procedures and are not meant to be an exclusive or exhaustive list of heightened inspection procedures a member may need to put in place.

## Rule 3110 – Books and Records

### **Approval and Documentation Procedures for Changes in Account Name/Designation**

Amended Rule 3110(d) requires that, before a customer order is executed, the account name or designation must be placed upon the memorandum for each transaction. In addition, only a designated person who has passed a qualifying principal examination appropriate to the business of the firm may approve any changes in account names or designations. The designated person also must document the essential facts relied upon in approving the changes and maintain the record in a central location. A member must preserve any account designation change documentation for a period of not less than three years, with the documentation preserved for the first two years in an easily accessible place, as the term "easily accessible place" is used in SEC Rule 17a-4.<sup>40</sup> This preservation requirement will not only allow members to use existing recordkeeping systems to meet this requirement, but it will enable members to make the account designation change documentation promptly available if requested by NASD examination staff. It also coincides with Rule 3110's existing mandate that members' recordkeeping format, medium, and retention periods comply with SEC Rule 17a-4 requirements.<sup>41</sup>

Because changes in account names or designations in connection with order executions can be subject to abuse, NASD believes that a qualified person should approve such changes and a member should adequately document them. NASD understands that some members, especially those that use clerical staff to make these changes, may incur additional costs by requiring that a principal be informed of the surrounding facts of the change and authorize it. However, NASD believes that account names and designations are material, sensitive information that must be protected from possible fraudulent activity. Requiring a principal to authorize the change and be aware of the surrounding facts for the change is a relatively low-cost method of protecting this information.

NASD also believes that Rule 3110's new requirement that a name or account designation be placed on "each transaction" promotes consistency with members'

---

NASD and SEC books and records requirements. Specifically, SEC Rule 17a-3(a)(6) requires that a memorandum of each brokerage order identify, among other things, the account for which the order was entered. NASD expects that members, regardless of the type of securities business they engage in, will comply with this requirement in the same manner that they comply with the SEC's books and records requirements.

## IM-3110 – Customer Account Information

### Time Limits for Holding Customer Mail

Under revised IM-3110(i), a member, upon a customer's written instructions, may hold mail for a customer who will not be at his or her usual address for no longer than two months if the customer is on vacation or traveling, or three months if the customer is going abroad.

NASD understands that if a member provides a mail holding service to its customers, the member may have to put in place additional procedures to comply with the limitations set forth in IM-3110. However, the interpretive material helps to ensure that members that do hold mail for customers who are away from their usual addresses, do so only pursuant to the customers' written instructions and for a specified, relatively short period of time. Thus, there is a reduced likelihood of risk that customers would not receive account statements or other account documentation at their usual addresses. In addition, the interpretive material will help to ensure that customers provide members with which they do business current address information, insofar as a member will not be permitted to hold mail indefinitely.

## Rule 2510 – Discretionary Accounts

### One-Day Limit on Time/Price Discretionary Authority

Rule 2510(d)(1) allows members to exercise time and price discretion on orders for the purchase or sale of a definite amount of a specified security without prior written authorization from the customer or prior written approval by the member. However, the duration of this discretionary authority is limited to the day it is granted, absent written authorization to the contrary. In addition, any exercise of time and price discretion must be reflected on the customer order ticket.<sup>42</sup>

NASD believes that investors will receive greater protection by clarifying the time such an order remains pending. Customers who wish to grant more extensive discretionary authority to their registered representatives may do so pursuant to a fully executed trading authorization.

NASD does not believe that a general institutional exemption from the one-day time and price limit would be appropriate. However, Rule 2510's one-day limitation does not apply to time and price discretion exercised for orders effected with or for an institutional account, as that term is defined in Rule 3110(c)(4),<sup>43</sup> pursuant to valid Good-Till-Cancelled instructions issued on a "not held" basis.<sup>44</sup>

---

## Endnotes

- 1 Exchange Act Rel. No. 49883 (June 17, 2004), 69 F.R. 35092 (June 23, 2004) (SR-NASD-2002-162).
- 2 Exchange Act Rel. No. 50477 (September 30, 2004), 69 F.R. \_\_\_\_ (October \_\_, 2004) (SR-NASD-2004-116).
- 3 The approved rule text in Attachment A also shows some minor changes to Rule 9610 (Application) – specifically, the replacement of “Association” and “NASD Regulation” with “NASD.”
- 4 See *Frank Gruttadauria*, NYSE Disc. Action 2002-59 (March 19, 2002); SEC Litigation Rel. No. 17590 (June 27, 2002).
- 5 IM-3013 provides that the responsibility for discharging compliance policies and written supervisory procedures rests with the firm’s business line supervisors. These supervisors are the persons responsible for executing the supervisory policies and procedures Rule 3010 requires firms to establish and adopt.
- 6 Rule 3012(a)(1)(A) & (B).
- 7 Rule 3012(a)(2)(A).
- 8 Rule 3012(a)(2)(A)(i). NASD expects that supervision of the customer account activity of any supervisor will be performed in the same manner and on the same periodic basis as the member executes the supervision of the customer account activity of non-supervising registered representatives, assuming such manner and frequency of supervision is reasonably designed to comply with applicable securities laws and regulations and NASD rules.
- 9 Rule 3012(a)(2)(A)(i).
- 10 Rule 3012(a)(2)(C).
- 11 *Id.*
- 12 Rule 3012(a)(2)(A)(ii). Under the general supervisory review requirement, a senior or “otherwise independent” person is not required to be a principal. The requirement that a principal conduct the supervisory reviews performed under the “limited size and resources” exception is designed, in absence of the other controls provided in the general supervisory review requirement, to ensure that a suitably qualified person conducts the supervisory reviews and assumes responsibility for the reviews and the reviews’ findings.
- 13 Rule 3012(a)(2)(A)(ii).
- 14 Rule 3012(a)(2)(A)(iii).
- 15 Rule 3012(a)(2)(B)(i) through (iii).
- 16 Rule 3012(a)(2)(B).
- 17 *Id.*
- 18 Rule 3012(b). This provision references the NYSE’s recent similar amendments to enhance its members’ supervisory and supervisory control systems. Exchange Act Release No. 49882 (June 17, 2004), 69 F.R. 35108 (June 23, 2004).
- 19 Rule 3010(c)(1)(A). The approved rule changes have not altered Rule 3010’s existing requirement that members inspect at least annually their offices of supervisory jurisdiction (OSJ). See *id.*
- 20 Rule 3010(g)(2)(B). NASD has filed with the SEC a separate proposed rule change to Rule 3010(g)(2) that addresses other situations where a location of a member may be considered a “branch office” and affects only the content of what is now being renumbered as paragraph (2)(A) of Rule 3010(g). See Exchange Act Rel. No. 48897 (December 9, 2003), 68 F.R. 70059 (December 16, 2003) (SR-NASD-2003-104).
- 21 *Notice to Members* (NtM) 99-45 (June 1999); see also NtM 98-38 (May 1998).
- 22 Rule 3010(c)(1)(B).
- 23 Rule 3010(c)(1)(B); see NtM 99-45 (June 1999).
- 24 NtM 99-45 (June 1999).
- 25 Rule 3010(c)(1)(B).
- 26 Rule 3010(c)(1)(C).
- 27 Rule 3010(c)(1)(C); see NtM 99-45 (June 1999); see also NtM 98-38 (May 1998).
- 28 NtM 99-45 (June 1999); see also NtM 98-38 (May 1998).

- 
- 29 Rule 3010(g)(2)(B).
- 30 Rule 3010(g)(2)(A)(iv).
- 31 *Id.*
- 32 Rule 3010(c)(2)(A) through (F).
- 33 Finally, NASD expects a member to furnish its office inspection reports produced pursuant to Rule 3010 during any examination by a government entity or self-regulatory organization (SRO) if the information contained in the reports is relevant to the subject matter of the examination or if it is requested for production by the government entity or SRO. See SR-NASD-2002-162 – Amendment No. 3, at 11 (December 16, 2003).
- 34 The requirement that a principal conduct the office inspections under the “limited size and resources” exception is designed to ensure that, absent a firm’s ability to meet the general restrictions on who may conduct office inspections, a suitably qualified person will conduct the office inspections and assume responsibility for the inspections and the reports generated by those inspections. If a member firm is not using the “limited size and resources” exception, the firm is not required to use principals to conduct its office inspections.
- 35 Rule 3010(c)(3). One method of complying with this requirement would be to include in the inspection report a precise listing of the firm’s size and resources and how the firm’s size and resources cannot be configured to comply with the general inspection requirement.
- 36 During the rulemaking process, NASD received comments from its member firms that if firms with an independent dealer model could not use their usual practice of having the branch office manager/OSJ manager conduct inspections of satellite offices, it would impose a considerable strain on the firms’ existing compliance resources. In response to these comments, NASD specifically recognized that the independent dealer model would fit within the “limited size and resources” exception to the prohibitions on who may conduct office inspections. SR-NASD-2002-162 – Amendment No. 3, at 15-16 (December 16, 2003).
- 37 Rule 3010(c)(3).
- 38 *Id.*
- 39 *Id.*
- 40 Rule 3110(d).
- 41 See Rule 3110(a).
- 42 Rule 2510(d)(1).
- 43 Rule 3110(c)(4) provides that the term “institutional account” means the account of:
- (A) a bank, savings and loan association, insurance company, or registered investment company;
- (B) an investment adviser registered either with the Securities and Exchange Commission under Section 203 of the Investment Advisers Act of 1940 or with a state securities commission (or any agency or office performing like functions); or
- (C) any other entity (whether a natural person, corporation, partnership, trust, or otherwise) with total assets of at least \$50 million.
- 44 Rule 2510(d)(1).

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

---

## ATTACHMENT A

New rule text is underlined; deleted rule text is bracketed.

### 2510. Discretionary Accounts

(a) through (c) No change.

#### (d) Exceptions

This Rule shall not apply to:

(1) discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a security shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent a specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined in Rule 3110(c)(4), pursuant to valid Good-Till-Cancelled instructions issued on a "not-held" basis. Any exercise of time and price discretion must be reflected on the order ticket;

(2) No Change.

\* \* \* \* \*

### 3010. Supervision

#### (a) Supervisory System

Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules [the Rules of this Association]. Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) through (7) No change.

(8) Each member shall designate and specifically identify to the Association one or more principals who shall review the supervisory system, procedures, and inspections implemented by the member as required by this Rule and take or recommend to senior management appropriate action reasonably designed to achieve the member's compliance with applicable securities laws and regulations, and with the Rules of this Association.]

(b) No change.

---

(c) Internal Inspections

(1) Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable NASD rules [the Rules of this Association]. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses [and at least an annual inspection of each office of supervisory jurisdiction. Each branch office of the member shall be inspected according to a cycle which shall be set forth in the firm's written supervisory and inspection procedures. In establishing such cycle, the firm shall give consideration to the nature and complexity of the securities activities for which the location is responsible, the volume of business done, and the number of associated persons assigned to the location.]

(A) Each member shall inspect at least annually every office of supervisory jurisdiction and any branch office that supervises one or more non-branch locations.

(B) Each member shall inspect at least every three years every branch office that does not supervise one or more non-branch locations. In establishing how often to inspect each non-supervisory branch office, the firm shall consider whether the nature and complexity of the securities activities for which the location is responsible, the volume of business done, and the number of associated persons assigned to the location require the non-supervisory branch office to be inspected more frequently than every three years. If a member establishes a more frequent inspection cycle, the member must ensure that at least every three years, the inspection requirements enumerated in paragraph (c)(2) have been met. The non-supervisory branch office examination cycle, an explanation of the factors the member used in determining the frequency of the examinations in the cycle, and the manner in which a member will comply with paragraph (c)(2) if using more frequent inspections than every three years shall be set forth in the member's written supervisory and inspection procedures.

(C) Each member shall inspect on a regular periodic schedule every non-branch location. In establishing such schedule, the firm shall consider the nature and complexity of the securities activities for which the location is responsible and the nature and extent of contact with customers. The schedule and an explanation regarding how the member determined the frequency of the examination schedule shall be set forth in the member's written supervisory and inspection procedures.

Each member shall retain a written record of the dates upon which each review and inspection is conducted.

---

(2) An office inspection and review by a member pursuant to paragraph (c)(1) must be reduced to a written report and kept on file by the member for a minimum of three years, unless the inspection is being conducted pursuant to paragraph (c)(1)(C) and the regular periodic schedule is longer than a three-year cycle, in which case the report must be kept on file at least until the next inspection report has been written. The written inspection report must also include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures in the following areas:

- (A) Safeguarding of customer funds and securities;
- (B) Maintaining books and records;
- (C) Supervision of customer accounts serviced by branch office managers;
- (D) Transmittal of funds between customers and registered representatives and between customers and third parties;
- (E) Validation of customer address changes; and
- (F) Validation of changes in customer account information.

If a member does not engage in all of the activities enumerated above, the member must identify those activities in which it does not engage in the written inspection report and document in the report that supervisory policies and procedures for such activities must be in place before the member can engage in them.

(3) An office inspection by a member pursuant to paragraph (c)(1) may not be conducted by the branch office manager or any person within that office who has supervisory responsibilities or by any individual who is directly or indirectly supervised by such person(s). However, if a member is so limited in size and resources that it cannot comply with this limitation (e.g., a member with only one office or a member [with] has a business model where small or single-person offices report directly to an office of supervisory jurisdiction manager who is also considered the offices' branch office manager), the member may have a principal who has the requisite knowledge to conduct an office inspection perform the inspections. The member, however, must document in the office inspection reports the factors it has relied upon in determining that it is so limited in size and resources that it has no other alternative than to comply in this manner.

A member must have in place procedures that are reasonably designed to provide heightened office inspections if the person conducting the inspection reports to the branch office manager's supervisor or works in an office supervised by the branch manager's supervisor and the branch office manager generates 20% or more of the revenue of the business units supervised by the branch office manager's supervisor. For the purposes of this subsection only, the term "heightened inspection" shall mean those inspection procedures that are designed to avoid conflicts of interest that serve to undermine complete and effective inspection because of

---

the economic, commercial, or financial interests that the branch manager's supervisor holds in the associated persons and businesses being inspected. In addition, for the purpose of this section only, when calculating the 20% threshold, all of the revenue generated by or credited to the branch office or the branch office manager shall be attributed as revenue generated by the business units supervised by the branch office manager's supervisor irrespective of a member's internal allocation of such revenue. A member must calculate the 20% threshold on a rolling, twelve-month basis.

\* \* \* \* \*

**(g) Definitions**

(1) No change.

(2)(A) "Branch Office" means any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business, excluding:

(A) through (D) renumbered as (i) through (iv).

(2)(B) Notwithstanding the exclusions provided in paragraph (2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more non-branch locations of the member is considered to be a branch office.

(3) No change.

## **3012. Supervisory Control System**

**(a) General Requirements**

(1) Each member shall designate and specifically identify to NASD one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures that (A) test and verify that the member's supervisory procedures are reasonably designed with respect to the activities of the member and its registered representatives and associated persons, to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules and (B) create additional or amend supervisory procedures where the need is identified by such testing and verification. The designated principal or principals must submit to the member's senior management no less than annually, a report detailing each member's system of supervisory controls, the summary of the test results and significant identified exceptions, and any additional or amended supervisory procedures created in response to the test results.

---

(2) The establishment, maintenance, and enforcement of written supervisory control policies and procedures pursuant to paragraph (a) shall include:

(A) procedures that are reasonably designed to review and supervise the customer account activity conducted by the member's branch office managers, sales managers, regional or district sales managers, or any person performing a similar supervisory function.

(i) A person who is either senior to, or otherwise independent of, the producing manager must perform such supervisory reviews. For purposes of this Rule, an "otherwise independent" person: may not report either directly or indirectly to the producing manager under review; must be situated in an office other than the office of the producing manager; must not otherwise have supervisory responsibility over the activity being reviewed (including not being directly compensated based in whole or in part on the revenues accruing for those activities); and must alternate such review responsibility with another qualified person every two years or less.

(ii) If a member is so limited in size and resources that there is no qualified person senior to, or otherwise independent of, the producing manager to conduct the reviews pursuant to (i) above (e.g., a member has only one office or an insufficient number of qualified personnel who can conduct reviews on a two-year rotation), the reviews may be conducted by a principal who is sufficiently knowledgeable of the member's supervisory control procedures, provided that the reviews are in compliance with (i) to the extent practicable.

(iii) A member relying on (ii) above must document in its supervisory control procedures the factors used to determine that complete compliance with all of the provisions of (i) is not possible and that the required supervisory systems and procedures in place with respect to any producing manager comply with the provisions of (i) above to the extent practicable.

(B) procedures that are reasonably designed to review and monitor the following activities:

(i) all transmittals of funds (e.g., wires or checks, etc.) or securities from customers to third party accounts (i.e., a transmittal that would result in a change of beneficial ownership); from customer accounts to outside entities (e.g., banks, investment companies, etc.); from customer accounts to locations other than a customer's primary residence (e.g., post office box, "in care of" accounts, alternate address, etc.); and between customers and registered representatives, including the hand-delivery of checks;

(ii) customer changes of address and the validation of such changes of address; and

---

(iii) customer changes of investment objectives and the validation of such changes of investment objectives.

The policies and procedures established pursuant to paragraph (a)(2)(B) must include a means or method of customer confirmation, notification, or follow-up that can be documented. If a member does not engage in all of the activities enumerated above, the member must identify those activities in which it does not engage in its written supervisory control policies and procedures and document in those policies and procedures that additional supervisory policies and procedures for such activities must be in place before the member can engage in them; and

(C) procedures that are reasonably designed to provide heightened supervision over the activities of each producing manager who is responsible for generating 20% or more of the revenue of the business units supervised by the producing manager's supervisor. For the purposes of this subsection only, the term "heightened supervision" shall mean those supervisory procedures that evidence supervisory activities that are designed to avoid conflicts of interest that serve to undermine complete and effective supervision because of the economic, commercial, or financial interests that the supervisor holds in the associated persons and businesses being supervised. In addition, for the purpose of this section only, when calculating the 20% threshold, all of the revenue generated by or credited to the producing manager or the producing manager's office shall be attributed as revenue generated by the business units supervised by the producing manager's supervisor irrespective of a member's internal allocation of such revenue. A member must calculate the 20% threshold on a rolling, twelve-month basis.

**(b) Dual Member**

Any member in compliance with substantially similar requirements of the New York Stock Exchange, Inc. shall be deemed to be in compliance with the provisions of this Rule.

\* \* \* \* \*

### **3110. Books and Records**

(a) through (b) No change.

**(c) Customer Account Information**

(1) through (3) No change.

---

(4) For purposes of this Rule, [and] Rule 2310, and Rule 2510 the term "institutional account" shall mean the account of:

(A) through (C) No change.

**(d) Changes in Account Name or Designation**

Before any customer order is executed, there must be placed upon the memorandum for each transaction, the name or designation of the account (or accounts) for which such order is to be executed. No change in such account name(s) (including related accounts) or designation(s) (including error accounts) shall be made unless the change has been authorized by a member or a person(s) designated under the provisions of NASD rules. Such person must, prior to giving his or her approval of the account designation change, be personally informed of the essential facts relative thereto and indicate his or her approval of such change in writing on the order or other similar record of the member. The essential facts relied upon by the person approving the change must be documented in writing and preserved for a period of not less than three years, the first two years in an easily accessible place, as the term "easily accessible place" is used in SEC Rule 17a-4. For purposes of this paragraph (d), a person(s) designated under the provisions of NASD rules to approve account name or designation changes must pass a qualifying principal examination appropriate to the business of the firm.

\* \* \* \* \*

**IM-3110. Customer Account Information**

(a) through (h) No Change.

**(i) Holding of Customer Mail**

Upon the written instructions of a customer, a member may hold mail for a customer who will not be at his or her usual address for the period of his or her absence, but (A) not to exceed two months if the member is advised that such customer will be on vacation or traveling or (B) not to exceed three months if the customer is going abroad.

\* \* \* \* \*

---

## 9610. Application

### (a) Where to File

A member seeking an exemption from Rule 1021, 1022, 1070, 2210, 2320, 2340, 2520, 2710, 2720, 2810, 2850, 2851, 2860, Interpretive Material 2860-1, 3010(b)(2), 3020, 3210, 3230, 3350, 8211, 8212, 8213, 11870, or 11900, Interpretive Material 2110-1, or Municipal Securities Rulemaking Board Rule G-37 shall file a written application with the appropriate department or staff of NASD [the Association] and provide a copy of the application to the Office of General Counsel of NASD [Regulation].

(b) through (c) No Change.

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Broker-Dealer of Record  
Customer Account Transfers  
Mutual Funds  
Negative Response Letters  
Rule 2110  
Variable Annuities

## GUIDANCE

### Transfers of Mutual Funds and Variable Annuities

Impermissible Use of Negative Response Letters for the Transfer of Mutual Funds and Variable Annuities (Changes in Broker-Dealer of Record)

#### Executive Summary

In September 2002, NASD issued *Notice to Members (NtM) 02-57* addressing when a member firm can use “negative response letters” for the bulk transfer of customer accounts, consistent with NASD rules. Since the publication of NtM 02-57, the staff has received a number of inquiries from the membership for guidance on the use of negative response letters to change the “broker-dealer of record” (hereinafter, BD of record) on a mutual fund or variable insurance product account held directly with the issuer. As indicated in NtM 02-57, changes in BD of record under these circumstances fall outside the scope of NtM 02-57. Accordingly, a member must obtain affirmative consent from a customer to direct a change in the BD of record in either a mutual fund or variable annuity account.

#### Questions/Further Information

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

---

## Background and Discussion

In September 2002, NASD issued NtM 02-57 concerning the use of negative response letters<sup>1</sup> for the bulk transfer of customer accounts. In NtM 02-57, NASD staff expressed its general view that a customer should affirmatively consent to the transfer of his or her account to another firm. The staff explained that when a firm initiates the transfer of a customer's account via a negative response letter, there is no assurance that the customer has had sufficient time or information with which to decide whether to object to the transfer. The staff further observed that members may be inclined to use negative response letters because of the convenience these letters provide, without giving due consideration to whether soliciting affirmative customer consent is a viable alternative. The staff concluded that transfers of customer accounts by a member using negative response letters may, under certain circumstances, conflict with a member's obligation to observe high standards of commercial honor and just and equitable principles of trade under NASD Rule 2110.<sup>2</sup>

The staff, however, identified five specific situations in which it believed negative response letters could be appropriate to transfer customer accounts. These situations involve:

- ◆ A member experiencing financial or operational difficulties;
- ◆ An introducing firm no longer in business;
- ◆ Changes in a networking arrangement with a financial institution;
- ◆ An acquisition or merger of a member firm; and
- ◆ A change in a clearing firm by an introducing firm.

The staff specifically indicated in NtM 02-57 that the guidance in the *Notice* did not apply to transfers of special product accounts such as mutual fund or variable annuity accounts, nor did it apply to the transfer of specific securities.<sup>3</sup> This statement reflected the staff's belief that such situations did not merit an exception from the general principle that firms should obtain affirmative consent from a customer prior to transferring such accounts (including changing the BD of record) or specific securities.

Since the issuance of NtM 02-57, however, NASD staff has received a number of inquiries regarding the potential application of the principles in the *Notice* to changes in BD of record, specifically whether members can use negative response letters to change the BD of record in mutual fund or variable insurance product accounts held directly with the issuer. The BD of record refers to the broker-dealer identified on a customer's account application for accounts held directly at a mutual fund or variable insurance product issuer. Accounts held in this manner are sometimes referred to as "check and application," "application way," or "direct application" (for consistency, this *Notice* uses the term "direct application") business. The BD of record generally receives fees or commissions resulting from the customer's transactions in the account.

---

NASD staff is issuing this *Notice* to reaffirm that the guidance provided in NtM 02-57 regarding the use of negative response letters does not apply to changes of BD of record for mutual fund and variable insurance product accounts where the account is held directly with the issuer. As explained in NtM 02-57, the use of negative response letters to facilitate a bulk transfer of customer accounts is generally appropriate in the five specified situations primarily because the bulk transfer of accounts helps minimize interruptions to customers' access to their accounts and the trading markets. However, because a change in the BD of record does not affect the owner's access to his or her account, changing the BD of record on a "direct application" account does not present such concerns. Nor does a change in the BD of record materially alter any of the account features, such as account holders, assets, investment objectives, etc. Rather, the change predominantly affects who will receive any fees and commissions the mutual fund or variable insurance product issuer may pay.

Given that the considerations that make the use of negative response letters appropriate in the five situations outlined in NtM 02-57 are not present when a "direct application" account's BD of record is changed, a member should seek a customer's affirmative consent prior to changing the BD of record on the customer's "direct application" account. The staff understands that the member may incur some cost and encounter some inconvenience when seeking affirmative consent to change a BD of record. However, a customer should be given sufficient time and information with which to decide whether a new BD of record should be named on the customer's account.

## Endnotes

- 1 A negative response letter generally informs the recipient of the letter of an impending action and requires the recipient to respond or act within a specified time frame if the recipient objects to the action. If the recipient does not respond, he or she is deemed to have consented to the action.
- 2 See *also* Letter to Merit Capital Associates, Inc., from Office of General Counsel, NASD Regulation, Inc. (predecessor to NASD Regulatory Policy and Oversight) dated October 16, 2000.
- 3 See NtM 02-57 (September 2002) n.1 ("*This Notice to Members* does not apply to transfers of special product accounts such as mutual fund or variable annuity accounts, nor does it apply to the transfer of specific securities. Further, certain account transfers may require NASD approval under Rule 1017.").

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Legal & Compliance  
Registered Representatives  
Senior Management

## KEY TOPICS

Examination Fees  
Qualification Examinations  
Registration  
Schedule A to the NASD By-Laws

## GUIDANCE

### Examination Fees

Amendments to Section 4 of Schedule A to the NASD By-Laws Governing Qualification Examination Fees;  
**Implementation Date: January 1, 2005**

### Executive Summary

NASD has filed for immediate effectiveness amendments to Section 4 of Schedule A to the NASD By-Laws.<sup>1</sup> The amendments increase certain examination fees, as described below, and also list the fees for all qualification examinations that may be required by NASD for its members, regardless of whether the current examination fee has been increased.

The amendments to Section 4 become operative on January 1, 2005. The published fee schedule represents the fee that will be charged at the time the individual registers for the examination, starting on January 1, 2005. The individual then has 120 days in which to take the examination.

Included with this *Notice* is Attachment A, the text of amended Section 4.

### Questions/Further Information

Questions concerning this *Notice* may be directed to Ann Griffith, Associate Vice President and Director, Testing and Continuing Education, at (240) 386-5051.

---

## Background and Discussion

Any person associated with a member firm who is engaged in the securities business of the firm must register with NASD. As part of the registration process, securities professionals must pass a qualification examination to demonstrate competence in the areas in which they intend to work. NASD sponsors (*i.e.*, develops) some of these examinations while others are sponsored by NASAA, NYSE, MSRB, and other self-regulatory organizations (SROs).

NASD administers these qualification examinations on behalf of the securities industry. NASD owns a proprietary system (the PROCTOR® system) to administer qualification examinations to securities industry professionals via computer. The examinations are delivered to candidates at test centers operated by vendors under contract with NASD.<sup>2</sup>

NASD has not adjusted examination fees for NASD-sponsored examinations since 1989, nor has NASD increased the fees charged to its clients for administration and delivery of their examinations during that same time period. NASD recently conducted an analysis of the costs of developing, administering, and delivering qualification examinations. The analysis showed that NASD's costs, particularly technology<sup>3</sup> and delivery costs, are rising. After consulting with several NASD committees and the clients for whom NASD administers and delivers examinations, NASD staff received approval from the NASD Finance Committee to adjust examination and delivery fees beginning in January 2005.

The amendments to Schedule A eliminate existing provisions relating to specific examinations and, instead, list all qualification examinations that may be required by NASD for its members. The fees for these examinations represent the fees to be charged persons who register for any of these examinations beginning on January 1, 2005.<sup>4</sup> NASD plans to conduct an annual review of its costs and adjust examination and delivery fees, if necessary, as of January 1 each year after making the appropriate rule filings.

---

## Fee Changes

As a result of the cost increases explained above, examination fees for the following examinations that are delivered by NASD and that may be required by NASD for its members<sup>5</sup> will be adjusted as follows:

### Series 4

Registered Options Principal  
(Sponsored jointly by AMEX, CBOE,  
NASD, NYSE, PCX, and PHLX)

*From \$75 to \$80*

---

### Series 6

Investment Company Products/  
Variable Contracts Representative  
(NASD-sponsored)

*From \$60 to \$70*

---

### Series 7

General Securities Representative  
(NYSE-sponsored)

*From \$200 to \$225*

---

### Series 9

General Securities Sales  
Supervisor – Options Module  
(Sponsored jointly by AMEX, CBOE,  
MSRB, NASD, NYSE, PCX, and PHLX)

*From \$50 to \$60*

---

### Series 10

General Securities Sales  
Supervisor – General Module  
(Sponsored jointly by AMEX, CBOE,  
MSRB, NASD, NYSE, PCX, and PHLX)

*From \$60 to \$95*

---

### Series 22

Direct Participation Programs  
Representative  
(NASD-sponsored)

*From \$60 to \$70*

---

### Series 24

General Securities Principal  
(NASD-sponsored)

*From \$75 to \$85*

---

### Series 27

Financial and Operations Principal  
(NASD-sponsored)

*From \$75 to \$85*

---

### Series 55

Limited Representative – Equity Trader  
Examination  
(NASD-sponsored)

*From \$60 to \$80*

---

### Series 62

Corporate Securities Limited  
Representative  
(NASD-sponsored)

*From \$60 to \$70*

---

### Series 72

Government Securities Representative  
(NASD-sponsored)

*From \$60 to \$80*

---

### Series 87

Research Analyst – Regulatory  
(sponsored jointly by NASD and NYSE)

*From \$100 to \$105*

---

---

## Publication of Fee Schedule in Schedule A

NASD will publish the following schedule of qualification examination fees in Schedule A.

<b>Series 4</b>	Registered Options Principal	\$80
<b>Series 6</b>	Investment Company Products/Variable Contracts Representative	\$70
<b>Series 7</b>	General Securities Representative	\$225
<b>Series 9</b>	General Securities Sales Supervisor – Options Module	\$60
<b>Series 10</b>	General Securities Sales Supervisor – General Module	\$95
<b>Series 11</b>	Assistant Representative-Order Processing	\$60
<b>Series 17</b>	Limited Registered Representative	\$65
<b>Series 22</b>	Direct Participation Programs Representative	\$70
<b>Series 23</b>	General Securities Principal Sales Supervisor Module	\$75
<b>Series 24</b>	General Securities Principal	\$85
<b>Series 26</b>	Investment Company Products/Variable Contracts Principal	\$75
<b>Series 27</b>	Financial and Operations Principal	\$85
<b>Series 28</b>	Introducing Broker-Dealer Financial and Operations Principal	\$75
<b>Series 37</b>	Canada Module of S7 (Options Required)	\$150
<b>Series 38</b>	Canada Module of S7 (No Options Required)	\$150
<b>Series 39</b>	Direct Participation Programs Principal	\$75
<b>Series 42</b>	Registered Options Representative	\$60
<b>Series 55</b>	Limited Representative – Equity Trader	\$80
<b>Series 62</b>	Corporate Securities Limited Representative	\$70
<b>Series 72</b>	Government Securities Representative	\$80
<b>Series 82</b>	Limited Representative – Private Securities Offering	\$75
<b>Series 86</b>	Research Analyst – Analysis	\$150
<b>Series 87</b>	Research Analyst – Regulatory	\$105

---

## Endnotes

- 1 Under Section 19(b) of the Securities Exchange Act of 1934, the SEC has the authority to summarily abrogate this type of rule change within 60 days of filing.
- 2 The vendors are Pearson Professional Centers (contact Pearson VUE's National Registration Center toll-free at 1-866-396-6273 or 952-681-3873 (toll number)) and Prometric Testing Centers (contact Prometric's National Call Center toll-free at 1-800-578-6273 or go to [www.prometric.com/nasd](http://www.prometric.com/nasd) for Web-based scheduling).  
  
NASD's contract with Pearson in January 2004 added more than 200 test centers to the existing network. With this addition, candidates may choose from more than 400 test delivery centers located throughout the United States and overseas.
- 3 A substantial proportion of the cost increase is attributable to the need to redesign and rebuild the current PROCTOR® system, which is more than 10 years old. The new system, expected to be deployed in 2006, will incorporate up-to-date technology and will include many new features such as additional item (question) formats (short answer, matching, drag/drop), on-line exhibits, and advanced biometrics for greater security.
- 4 The published fee represents the fee that will be charged at the time the individual registers for the examination. The individual then has 120 days to take the examination.
- 5 NASD also administers and delivers examinations sponsored by NYSE, MSRB, NASAA, PHLX, and NFA that, while not required by NASD rules, are taken by persons associated with NASD members to obtain certain licenses. Fees for the following examinations developed by these sponsors will be adjusted as follows effective January 1, 2005: NYSE—Series 12 (Branch Manager), from \$75 to \$80. MSRB—Series 52 (Municipal Securities Representative), from \$60 to \$80; Series 53 (Municipal Securities Principal), from \$75 to \$80. NASAA—Series 63 (Uniform Securities Agent State Law), from \$70 to \$82; Series 65 (Uniform Investment Advisor Law), from \$110 to \$120. NFA—Series 3 (National Commodity Futures), from \$75 to \$90.

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

---

## ATTACHMENT A

New language is underlined; deletions are in brackets.

### SCHEDULE A TO THE NASD BY-LAWS

\* \* \* \* \*

#### Section 4--Fees

(a) and (b) No change

(c) [There shall be an examination fee of \$60.00 assessed as to each individual who is required to take an examination for registration as a registered representative pursuant to the provisions of the Rule 1030 Series, except that the examination fee for general securities representatives shall be \$110.00.] The following fees shall be assessed to each individual who registers to take an examination as described below as of January 1, 2005. [This] These fees [is] are in addition to the registration fee described in [Item] paragraph (b). [Persons for whom an examination is waived pursuant to Rule 1070 shall pay a fee as set forth in paragraph (l) of this Section.]

<u>Series 4</u>	<u>Registered Options Principal</u>	<u>\$80</u>
<u>Series 6</u>	<u>Investment Company Products/Variable Contracts Representative</u>	<u>\$70</u>
<u>Series 7</u>	<u>General Securities Representative</u>	<u>\$225</u>
<u>Series 9</u>	<u>General Securities Sales Supervisor-Options Module</u>	<u>\$60</u>
<u>Series 10</u>	<u>General Securities Sales Supervisor-General Module</u>	<u>\$95</u>
<u>Series 11</u>	<u>Assistant Representative-Order Processing</u>	<u>\$60</u>
<u>Series 17</u>	<u>Limited Registered Representative</u>	<u>\$65</u>
<u>Series 22</u>	<u>Direct Participation Programs Representative</u>	<u>\$70</u>
<u>Series 23</u>	<u>General Securities Principal Sales Supervisor Module</u>	<u>\$75</u>
<u>Series 24</u>	<u>General Securities Principal</u>	<u>\$85</u>
<u>Series 26</u>	<u>Investment Company Products/Variable Contracts Principal</u>	<u>\$75</u>
<u>Series 27</u>	<u>Financial and Operations Principal</u>	<u>\$85</u>
<u>Series 28</u>	<u>Introducing Broker/Dealer Financial and Operations Principal</u>	<u>\$75</u>
<u>Series 37</u>	<u>Canada Module of S7 (Options Required)</u>	<u>\$150</u>
<u>Series 38</u>	<u>Canada Module of S7 (No Options Required)</u>	<u>\$150</u>
<u>Series 39</u>	<u>Direct Participation Programs Principal</u>	<u>\$75</u>
<u>Series 42</u>	<u>Registered Options Representative</u>	<u>\$60</u>
<u>Series 55</u>	<u>Limited Representative-Equity Trader</u>	<u>\$80</u>
<u>Series 62</u>	<u>Corporate Securities Limited Representative</u>	<u>\$70</u>
<u>Series 72</u>	<u>Government Securities Representative</u>	<u>\$80</u>
<u>Series 82</u>	<u>Limited Representative-Private Securities Offering</u>	<u>\$75</u>
<u>Series 86</u>	<u>Research Analyst – Analysis</u>	<u>\$150</u>
<u>Series 87</u>	<u>Research Analyst – Regulatory</u>	<u>\$105</u>

---

(1) Persons for whom any qualification examination is waived pursuant to Rule 1070 shall be assessed as an application fee the examination fee for each qualification examination so waived.

(2) There shall be a service charge equal to the examination fee assessed as to each individual who, having made an appointment for a specific time and place for computer-based administration of an examination, fails to timely appear for such examination or timely cancel such appointment.

(3) There shall be a service charge fee of \$15.00 in addition to those fees specified above for any examination taken in a foreign test center located outside the territorial limits of the United States.

[(d) There shall be a New York Stock Exchange examination development fee of \$90.00 assessed as to each individual who takes a Series 7 examination for registration as a general securities representative. This fee is in addition to the registration and examination fees described in paragraphs (b) and (c) respectively.]

[(e) There shall be an examination fee of \$105.00 assessed as to each individual who takes a Series 86 examination for registration as a research analyst pursuant to Rule 1050. There shall be an examination fee of \$55.00 assessed as to each individual who takes a Series 87 examination for registration as a research analyst pursuant to Rule 1050. This fee is in addition to the registration fee described in paragraph (b). Persons for whom an examination is waived pursuant to Rule 1070 shall pay a fee as set forth in paragraph (l) of this Section.]

[(f) There shall be a New York Stock Exchange examination development fee of \$45.00 assessed as to each individual who takes a Series 86 or Series 87 examination for registration as a research analyst pursuant to Rule 1050. This fee is in addition to the registration and examination fees described in paragraphs (b) and (e) respectively.]

[(g) There shall be an examination fee of \$110.00 assessed as to each individual taking the General Securities-Sales Supervisor Examination. There shall be an examination fee of \$75.00 assessed as to each individual who is required to take any other examination for principals pursuant to the provisions of the Rule 1020 Series. Persons for whom an examination is waived pursuant to Rule 1070 shall pay a fee as set forth in paragraph (l) of this Section.]

[(h) There shall be a service charge fee of \$15.00 in addition to those fees specified in (b), (c), (d), (e) and (f) above for any examination taken in a foreign test center located outside the territorial limits of the United States.]

[(i) There shall be a service charge equal to the examination fee assessed as to each individual who, having made an appointment for a specific time and place for computer-based administration of an examination, fails to timely appear for such examination or timely cancel such appointment.]

(j) and (k) are renumbered (d) and (e).

[(l) Each individual who is granted a waiver(s) for any qualification examination specified in paragraphs (c), (e), or (g) of this section shall be assessed as an application fee the examination fee as set forth in paragraph (c), (e), (f), or (g) for each qualification examination so waived.]

(m) through (o) are renumbered (f) through (h).

\* \* \* \* \*

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Executive Representatives  
Legal & Compliance  
Operations  
Senior Management  
Registered Representative,  
Registration

## KEY TOPICS

IARD<sup>SM</sup>  
Maintenance Fees  
Registration  
Renewals  
Web CRD<sup>®</sup>

## ACTION REQUIRED

### Broker-Dealer and Investment Adviser Renewals

Broker-Dealer, Investment Adviser Firm, Agent and Investment Adviser Representative Renewals for 2005;  
**Payment Deadline: December 6, 2004**

#### Executive Summary

The 2005 NASD Broker/Dealer and Investment Adviser Registration Renewal Program will begin on November 8, 2004, when online Preliminary Renewal Statements are made available to all firms on Web CRD/IARD. This annual program simplifies the registration renewal process for more than 26,000 Broker/Dealer (BD) and Investment Adviser (IA) firms and over 800,000 registered representatives and investment adviser representatives with the payment of one amount to NASD by the published deadline. On **November 1, 2004**, firms may start submitting post-dated Forms U5, BDW, Schedule E, and ADV-W via Web CRD/IARD. Post-dated filings that are submitted by 11 p.m., Eastern Time (ET), November 5, 2004, will not appear on the firm's Preliminary Renewal Statement.

Renewal Statements will include the following fees: NASD Web CRD/IARD System Processing Fees, NASD Branch Office Fees, as well as New York Stock Exchange (NYSE), American Stock Exchange (Amex), Chicago Board Options Exchange (CBOE), International Securities Exchange (ISE), Pacific Exchange (PCX) and Philadelphia Stock Exchange (PHLX) Maintenance Fees. The statement will also include state Agent, state Broker/Dealer, and, if applicable, state Investment Adviser Firm and Investment Adviser Representative Renewal Fees.

---

**Please Note:** If you have not logged onto one of the following systems, Web CRD, IARD, Regulation Filing Applications, or the NASD Contact System since August 30, 2004, you may wish to do so prior to November 8, 2004, when Preliminary Renewal Statements become available. Web CRD and IARD were migrated to a new security platform on August 30, 2004, and you will have to complete a one-time, online, self-migration process to migrate your user account to the new NASD Entitlement security platform before being able to access those systems. You will need to provide your legacy User ID and Password, set a new password and select a security challenge question. The process should take less than five minutes. You can find out more information about the new NASD Entitlement Program at [www.nasdr.com/entitlement.asp](http://www.nasdr.com/entitlement.asp), including a user's self-migration job aide. Remember to note your new User ID and Password as they are what you will use after you have completed the self-migration.

Members should read this *Notice to Members* and any instructions posted to the NASD Web site under the Renewals button at [www.nasdr.com/3400\\_renewals\\_intro.asp](http://www.nasdr.com/3400_renewals_intro.asp), especially the CRD Fall Bulletin, which will be a special Renewal Program edition, the Investment Adviser Web site (if applicable), [www.iard.com/renewals.asp](http://www.iard.com/renewals.asp) for the IARD Renewals Bulletin, and any mailed information to ensure continued eligibility to do business as of January 1, 2005. Any Renewal processing changes, subsequent to the publishing of this *Notice to Members*, will be provided to you in a *Special Notice to Members*.

## Questions/Further Information

Questions concerning this *Notice* may be directed to the Gateway Call Center at (301) 869-6699.

## Preliminary Renewal Statements

Beginning **November 8, 2004**, Preliminary Renewal Statements will be available for viewing and printing on Web CRD for all entitled users. The statements will include the following fees: Web CRD/IARD System Processing Fees, NASD Branch Office Fees, NYSE, Amex, CBOE, ISE, PCX and PHLX Maintenance Fees, state Agent Renewal Fees, state Broker/Dealer, and, if applicable, Investment Adviser Firm and Representative Renewal Fees. NASD must **receive** full payment of the November Preliminary Renewal Statement amount no later than December 6, 2004.

If payment is **not** received by the **December 6, 2004, Payment Due Date**, the firm will be assessed a **Renewal Payment Late Fee**. This Renewal Payment Late Fee will be included as part of the firm's Final Renewal Statement and will be calculated as follows: 10 percent of a member firm's cumulative Final Renewal Assessment or \$100, whichever is greater, with a cap of \$5,000. Please see *Notice to Members 02-48* for details.

---

## Fees

A fee of \$30 will be assessed for each person who renews his/her registration with any regulator through Web CRD. Firms can access a listing of agents for whom the firm will be assessed by requesting the Renewals-Firm Renewal Roster.

The *RA Renewal System Processing Fee* of \$45 will be assessed for every Investment Adviser Representative who renews through the IARD Program.

The *IARD Firm System Fee* of \$100 will be assessed for every state-registered Investment Adviser firm that renews through the IARD Program.

The *NASD Branch Office Assessment Fee* of \$75 per branch, based on the number of active NASD branches as of December 31, 2004, will be assessed.

NASD Personnel Assessment Fees are not assessed through the NASD Annual Renewal Program. NASD will mail all NASD member firms a separate billing for this fee during the first quarter of 2005. Firms can access a listing of agents for whom the firm will be assessed the Personnel Assessment Fee by requesting the Renewals-Firm Renewal Roster.

Renewal Fees for NYSE, Amex, CBOE, PCX, ISE, PHLX, and state registrations are also assessed in the Preliminary Renewal Statement on Web CRD. NYSE, Amex, CBOE, PCX, ISE, and PHLX Maintenance Fees and state Renewal Fees collected by NASD for firms that are registered with those exchanges and jurisdictions, as well as NASD Renewal Fees, are based on the number of NASD, NYSE, Amex, CBOE, PCX, ISE, and PHLX and state-registered personnel employed by the member firm.

Some participating states may require steps beyond the payment of Renewal Fees to NASD to complete the Broker/Dealer or Investment Adviser renewal process. Firms should contact each jurisdiction directly for further information on state renewal requirements. A Regulator Directory can be found at [www.nasaa.org/nasaa/abtnasaa/find\\_regulator.asp](http://www.nasaa.org/nasaa/abtnasaa/find_regulator.asp).

For detailed information regarding Investment Adviser renewals, you may also visit the Investment Adviser Web site, [www.iard.com](http://www.iard.com). A matrix that includes a list of Investment Adviser Renewal Fees for states that participate in the 2005 IARD Investment Adviser Renewal Program is posted at [www.iard.com/pdf/rep\\_fee\\_sch.pdf](http://www.iard.com/pdf/rep_fee_sch.pdf).

## Renewal Payment

Firms have four (4) payment methods available to pay 2005 Renewal Fees:

1. Web CRD/IARD E-Pay
2. Check
3. Wire payment, or
4. Request a transfer of the entire amount from the firm's Daily Account to its Renewal Account (Note: The entire amount of the payment must be available).

---

**Web E-Pay Instructions:**

The E-Payment application is accessible from both the Preliminary and Final Renewal Statements, and either the NASD ([www.nasdr.com/3400.asp](http://www.nasdr.com/3400.asp)) or IARD ([www.iard.com](http://www.iard.com)) Web sites and allows firms to make an ACH payment from a designated bank account to their Web CRD/IARD Renewal Account. In order for funds to be posted to the firm's Renewal Account by **DECEMBER 6, 2004**, payment must be submitted electronically, no later than 8:30 p.m., Eastern Time (ET) on December 2, 2004.

**Check Instructions:**

The check should be drawn on the member firm's account, with the firm's CRD Number included on the front of the check, along with the word "Renewals" in the memo line.

Firms should mail their Renewal Payment, **along with a print-out of the first page of their online Renewal Statement** directly to:

**U.S. Mail**

NASD, CRD-IARD

P.O. Box 7777-W8705

Philadelphia, PA 19175-8705

(Note: This P.O. Box will not accept courier or overnight deliveries)

or

**Express/Overnight Delivery**

NASD, CRD-IARD

W8705

c/o Mellon Bank, Rm 3490

701 Market Street

Philadelphia, PA 19106

Telephone No: (301) 869-6699

**Member firms should use the blue, pre-addressed Renewal Payment envelope that they are scheduled to receive the second week of November or, if using their own envelope, should use the full address, as noted above, including the "W8705" number shown in each address above to ensure prompt processing.**

**Please note:** The addresses for Renewal Payments are different from the addresses for funding your firm's CRD or IARD Daily Account.

---

To ensure prompt processing of your Renewal Payment check:

- ▶ Include a print-out of the first page of your Preliminary Renewal Statement with payment.
- ▶ Do *not* include any other forms or fee submissions.
- ▶ Write your firm's CRD Number and the word "Renewals" on the check memo line.
- ▶ Be sure to send your payment either in the blue pre-addressed Renewal Payment envelope that will be mailed to you or write the address on the envelope exactly as noted above.

**Wire Payment Instructions:**

Firms may wire full payment of the Preliminary Renewal Statement by requesting their bank to initiate the wire transfer to: "**Mellon Financial, Philadelphia, PA.**" Firms should provide their bank the following information:

Transfer funds to:	<b>Mellon Financial, Philadelphia, PA.</b>
ABA Number:	<b>031 000 037</b>
Beneficiary:	<b>NASD</b>
NASD Regulation Account Number:	<b>8-234-353</b>
Reference Number:	<b>Firm CRD Number and the word "Renewals"</b>

To ensure prompt processing of a Renewal Payment by wire payment:

- ▶ Remember to inform the bank that the funds are to be credited to the **NASD Bank Account**.
- ▶ Provide the firm's CRD Number and the word "Renewals" as reference only.
- ▶ Record the Confirmation Number of the wire payment provided by the bank.

**Transfer of Funds Instructions:**

Firms may also call the Gateway Call Center at (301) 869-6699 and request that a transfer of the full Renewal payment be transferred from the firm's Daily Account to its Renewal Account. **Note:** the firm must have the available funds in order for the transfer to be processed.

Members are advised that failure to return full payment of their Preliminary Renewals Statement to NASD by the December 6, 2004, deadline could cause a member to become ineligible to do business in the jurisdiction effective January 1, 2005.

---

## Renewal Reports

Beginning November 8, 2004, the Renewal Reports are available to request, print, and/or download via Web CRD. There will be three reports available for reconciliation with the Preliminary Renewal Statement. All three reports will also be available as downloads:

- ▶ **Firm Renewal Report** – applicable to Broker/Dealer and Investment Adviser Firms. This report lists individuals included in the 2005 Renewal Program processing and includes Billing Codes (if they have been supplied by the firm).
- ▶ **Branches Renewal Report** – applicable to NASD Members. This report lists each branch registered with NASD for which the firm is being assessed a fee. Firms should use this report to reconcile their records for Renewal purposes.
- ▶ **Approved AG Reg Without NASD Approval Report** – applicable to NASD Members. This report contains all individuals who are not registered with NASD but are registered with one or more jurisdictions. The report should be used throughout the year, including during the Renewal Program, as an aid for firms to reconcile personnel registrations. Firms should request this report as soon as possible to determine if any NASD registrations need to be requested or jurisdictions terminated prior to Renewal processing for the Preliminary Renewal Statement available on November 8, 2004. Any post-dated termination filings submitted by 11:00 p.m., ET on November 5, 2004 will not appear on the firm's Preliminary Renewal Statement.

## Filing Form U5

**Firms may begin submitting post-dated U5 filings on November 1, 2004.** If Forms U5 (either Full or Partial) are filed electronically via Web CRD by 11:00 p.m., ET November 5, 2004, for agents (AGs) and/or investment adviser representatives (RAs) terminating in one or more jurisdiction affiliations, those individuals' Renewal Fees will not be included on the Preliminary Renewal Statement.

The deadline for electronic filing of Form U5 for firms that want to terminate an agent affiliation before year-end 2004 is 6:00 p.m., ET, on December 18, 2004. Firms may file both Partial and Full Forms U5 with a post-dated **termination date of December 31, 2004.** (This is the only date that can be used for a post-dated Form U5.) The deadline for submission of all EFT (electronic file transfer) filings is 2:00 p.m., ET, December 18, 2004.

## Post-Dated Form Filings

Firms can begin electronically filing post-dated Forms U5, BDW, Schedule E and ADV-W via Web CRD/IARD on November 1, 2004. This functionality allows firms to file a termination form on, or after, November 1, 2004, with a termination date of December 31, 2004. Firms that submit post-dated termination filings by 11:00 p.m., ET on November 5, 2004, **will not** be assessed Renewal Fees for the terminated jurisdictions on their Preliminary Renewal Statement.

---

Firms that submit post-dated termination filings on, or after, November 8, 2004, will not be assessed Renewal Fees for the terminated jurisdictions on the Final Renewal Statement in January 2005. Those firms will see a credit balance on their Final Renewal Statement if the firm has not requested additional registrations to offset the credit balance.

Between November 1, 2004, and December 18, 2004, firms may process Forms U5, BDW, Schedule E, and ADV-W (both partial and full terminations) with a post-dated termination date of **December 31, 2004**. (This is the only date that can be used for a post-dated form filing.) If a Form U5, BDW, Schedule E, or ADV-W indicates a termination date of December 31, 2004, an agent, Broker/Dealer, and/or Investment Adviser (firm) and investment adviser representative (RA) may continue doing business in the jurisdiction until the end of the calendar year without being assessed 2005 Renewal Fees. Firms should access individual and/or firm registrations after a termination filing is submitted to ensure that electronic Forms U5, BDW, Schedule E, and ADV-W are filed by the Renewal filing deadline date of 6:00 p.m., ET on December 18, 2004.

Members should exercise care when submitting post-dated Forms U5, BDW, Schedule E, and ADV-W. NASD will systematically process these forms as they are submitted and cannot withdraw a post-dated termination once submitted and processed. A member that files a post-dated termination in error would have to file, electronically, a new Form U4, BD Amendment, or ADV when Web CRD/IARD resumes filing processing on January 3, 2005. New registration fees would be assessed as a result.

Firms should also review individual and firm registrations via Web CRD/IARD to ensure post-dated filings were submitted.

#### **Filing Form BDW**

The CRD Phase II Program allows firms requesting Broker/Dealer termination (either full or partial) to electronically file their Forms BDW via Web CRD. Firms that file either a Full or Partial Form BDW by 11:00 p.m., ET, November 5, 2004, will avoid the assessment of the applicable Renewal Fees on their Preliminary Renewal Statement, provided that the regulator is a CRD Phase II participant. Currently, there are four regulators that participate in Web CRD Renewals for agent fees, but do not participate in CRD Phase II:

- ◆ American Stock Exchange
- ◆ New York Stock Exchange
- ◆ Pacific Exchange
- ◆ Philadelphia Stock Exchange

---

Firms requesting termination with any of the above-listed regulators must submit a paper Form BDW directly to the regulator, as well as submit one electronically to Web CRD.

The deadline for electronic filing of Forms BDW for firms that want to terminate an affiliation before year-end 2004 is 6:00 p.m., ET, December 18, 2004. This same date applies to the filing of Forms BDW with regulators that are not Phase II participants. For information regarding the post-dating of Forms BDW with the termination date of December 31, 2004, see the section titled, "Post-Dated Form Filings."

#### **Filing Forms ADV to Cancel Notice Filings or Forms ADV-W to Terminate Registrations**

Firms that file either a Form ADV Amendment, unmarking a state (generating the status of "Removal Requested at End of Year"), or a Full or Partial Form ADV-W by 11:00 p.m., ET, November 5, 2004, will avoid the assessment of the applicable Renewal Fees on their Preliminary Renewal Statement. The deadline for electronic filing of Form ADV Amendments or Forms ADV-W for firms that want to cancel a Notice Filing or terminate a state registration before year-end 2004 is 6:00 p.m., ET, December 18, 2004. For information regarding post-dating Form ADV-W with the termination date of December 31, 2004, for state registrations, see the section below.

#### **Removing Open Registrations**

Throughout the year, firms have access to the "Approved AG Reg Without NASD Approval" Report via Web CRD. This report identifies agents whose NASD registrations are either terminated or have been changed to a "purged" status due to the existence of a deficient condition (*i.e.*, Exams or Fingerprints) but maintain an approved registration with a state. Member firms should use this report to terminate obsolete state registrations through the submission of Forms U5 or reinstate the NASD licenses through the filing of a Form U4 Amendment. This report should aid firms in the reconciliation of personnel registrations prior to year's end and should be requested as soon as possible. Requesting this report will enable firms to identify individuals who can be terminated by November 5, 2004, to avoid being charged for those individuals on their Preliminary Renewal Statement. The "Approved AG Reg Without NASD Approval" Report will also advise a firm if there are no agents at the firm within this category.

#### **Final Renewal Statements**

Beginning January 3, 2005, NASD will make available Final Renewal Statements via Web CRD and IARD. These statements will reflect the final status of Broker/Dealer, Registered Representative (AG), Investment Adviser Firm and Investment Adviser Representative (RA) registrations and/or Notice Filings as of December 31, 2004. Any adjustments in fees owed as a result of registration terminations, approvals, Notice Filings or transitions subsequent to the processing/posting of the Preliminary Renewal Statement will be made in the Final Renewal Statement on Web CRD.

- 
- ▶ If a firm has more agents, branch offices, or jurisdictions registered and/or Notice Filed on Web CRD and IARD at year-end than it did when the Preliminary Renewal Statement was generated, additional Renewal Fees will be assessed.
  - ▶ If a firm has fewer agents, branch offices, or jurisdictions registered and/or Notice Filed at year-end than it did when the Preliminary Renewal Statement was generated, a credit/refund will be issued. As of January 3, 2005, overpayments will be systemically transferred to a firm's Daily Account. A firm that has a credit (sufficient) balance in its Daily Account may request a refund by faxing or mailing a written request signed by the designated signatory to the User Support Unit at (240) 386-4849. The request should include a printout of the firm's credit balance as reflected on Web CRD.

Beginning January 3, 2005, NASD member firms and "Joint" firms should access the Web CRD Reports function for the **Firm Renewal Report**, which will list all renewed personnel with the NASD, NYSE, Amex, CBOE, PCX, ISE, PHLX, and each jurisdiction. Agents and RAs whose registrations are "approved" in any of these jurisdictions during November and December will be included in this roster. Registrations that are "pending approval" or are "deficient" at year's end will not be included in the Renewal Program. Member firms will also be able to request the **Branches Renewal Report** that lists all NASD branches for which they have been assessed. Downloaded versions of these reports will also be available.

Firms have until **February 4, 2005**, to report any discrepancies on the Renewal Reports. This is also the deadline for **receipt of final payment**. Specific information and instructions concerning the Final Renewal Statements and Renewal Reports will appear in the January 2005 *Notices to Members*. Firms may also refer to the Fall CRD *Bulletin*, which is devoted entirely to the 2005 NASD Renewal Program, and is available on the NASD Web site at [www.nasdr.com/3400\\_publications.asp](http://www.nasdr.com/3400_publications.asp).

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Appendix D to the Net Capital Rule  
Net Capital  
SEC Rule 15c3-1  
Subordination Agreements  
Subordinated Loans

## REQUEST FOR COMMENT

### Subordination Agreements

NASD Seeks Comment on Enhanced Disclosure for Subordination Agreements; **Comment Period Expires November 26, 2004**

#### Executive Summary

In 2002, NASD adopted a requirement that firms submitting subordination agreements to NASD staff for approval provide each investor with a Subordination Agreement Investor Disclosure Document (Disclosure Document), a signed copy of which must be provided to NASD staff before the agreement will be approved.<sup>1</sup> The purpose of the Disclosure Document is to help investors understand what a subordination agreement is and what risks investors assume when they enter into such agreements.

While NASD continues to believe that the disclosures contained in the Disclosure Document help investors assess the general risks of subordination agreements, NASD is concerned that investors may still be entering into subordination agreements with firms without fully appreciating the specific risks that may be involved. Accordingly, NASD is seeking comment on a proposal to require firms to provide investors with detailed, specific disclosure focused on the firm and the particular loan before entering into a subordination agreement with an investor. These disclosures would augment the existing risk disclosures currently required to be provided by the firm to investors.

#### Action Requested

NASD encourages all interested parties to comment on the proposal. Comments must be received by November 26, 2004. Members and other interested persons can submit their comments using the following methods:

- ◆ Mailing comments in hard copy to the address below; or
- ◆ E-mailing comments to [pubcom@nasd.com](mailto:pubcom@nasd.com).

---

To help NASD process and review comments more efficiently, persons commenting on this proposal should use only one method. Comments sent by hard copy should be mailed to:

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

**Important Notes:** The only comments that will be considered are those submitted pursuant to the methods described above. All comments received in response to this *Notice* will be made available to the public on the NASD Web site. Generally, comments will be posted on the NASD Web site one week after the end of the comment period.<sup>2</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) by the NASD Board, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.<sup>3</sup>

## Questions/Further Information

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Associate Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight (RPO), at (202) 728-8104; or Brant K. Brown, Counsel, Office of General Counsel, RPO, at (202) 728-6927.

## Background and Discussion

At times, a broker-dealer may borrow funds or securities from investors to enhance the firm's net capital position. To receive benefit under the SEC's net capital rule (Rule 15c3-1), funds or securities loaned by an investor to a broker-dealer must be the subject of a satisfactory subordination agreement. The subordination agreement sets forth the rights and obligations of the lender (*i.e.*, the investor) and the borrower (*i.e.*, the broker-dealer), and it provides that any claims by the lender must be subordinate to claims by other parties, including customers and employees of the firm. Before a subordination agreement becomes effective for net capital purposes, it must be reviewed and approved by the broker-dealer's designated examining authority (DEA).<sup>4</sup>

---

SEC Rule 15c3-1d(a)(1) provides that NASD, as a DEA, may require that subordination agreements “include such other provisions as deemed necessary or appropriate to the extent such provisions do not cause the subordination agreement to fail to meet the requirements of [Appendix D to Rule 15c3-1].” In 2002, the SEC approved an NASD rule change that requires firms, before entering into any subordination agreement with an investor, to deliver the Disclosure Document to the investor and receive a signed copy affirming that the investor has read it.<sup>5</sup> This rule became effective on July 15, 2002.

The Disclosure Document is intended to help investors understand what a subordination agreement is and what risks they assume when they enter into a subordination agreement. The Disclosure Document covers such topics as: (1) the two types of subordination agreements (subordinated loan agreements and secured demand note agreements); (2) the lack of SIPC protection; (3) the lack of private insurance protection; (4) the fact that any claim is subordinate or has no priority in payment over other lenders; (5) the lack of restrictions on the broker-dealer’s use of a lender’s funds or securities; and (6) the ability of a broker-dealer to force the sale of securities pledged as collateral. The Disclosure Document is a standard document that does not vary from firm to firm or from loan to loan; consequently, the disclosure is general and provides investors only with generic risk factors.

NASD is concerned that the general disclosures in the Disclosure Document alone may be insufficient to convey the specific risks of a particular subordination agreement and that, without some degree of detail about the specific subordination agreement and the broker-dealer firm, an investor is not able to assess accurately the appropriateness of the investment. Consequently, NASD is proposing that, in addition to the Disclosure Document, firms be required to provide an investor entering into a subordination agreement with specific, written disclosure concerning the proposed investment. Specifically, NASD is proposing to require firms to:

- ▶ provide the investor with a detailed statement concerning the intended use of proceeds;
- ▶ provide the investor with a detailed statement concerning the intended plan of financing;
- ▶ disclose the amounts, types, interest rates, and scheduled maturity dates of debt to which the intended loan will be subordinate;
- ▶ for any subordinated loans<sup>6</sup> with outstanding balances, disclose the outstanding balances, interest rates, and scheduled maturity dates of such loans and the number of investors involved; and
- ▶ provide the investor with a copy of the broker-dealer’s most recent audited financial statement.

---

Firms would be required to provide these disclosures to the investor in writing before entering into any subordination agreement.<sup>7</sup> To the extent that the information does not appear in the subordination agreement itself, the firm would be required to provide the investor with a separate, stand-alone document containing the required information. NASD believes that these firm-specific and loan-specific disclosures will provide investors with useful information that will aid them in determining whether subordination agreements are appropriate investments.<sup>8</sup>

### **1. Detailed Statement Concerning the Intended Use of Proceeds**

NASD proposes to require each firm to include in its disclosure a detailed statement concerning the firm's intended use of the proceeds from the subordinated loans. NASD recognizes that lenders are precluded from placing restrictions on how the broker-dealer may use the proceeds from a subordinated loan, and the Disclosure Document includes disclosure to this effect. Nevertheless, at the time a firm solicits or receives a subordination agreement, it is likely to have an *intended* use for those proceeds, and that use should be disclosed. For example, the broker-dealer would be required to disclose whether it is pursuing the funds to satisfy an arbitration award (and, if so, a description of such award) or to pay salaries (and, if so, a description of the persons receiving the salaries and the amounts). In short, the firm would be required to disclose the reason it is pursuing the loan.

### **2. Detailed Statement Concerning the Intended Plan of Financing**

NASD also proposes to require firms to include in its disclosure a detailed plan of financing. This plan would include (1) the amount of the subordinated loan sought from the individual investor and its interest rate and scheduled maturity date (*i.e.*, the date that repayment by the firm to the lender is required); (2) the total amount of subordinated loans sought from other investors for the same purpose and their interest rates and scheduled maturity dates; (3) the number of investors from which the firm *intends* to borrow funds; and (4) the approximate percentage of the total loan expected from each investor. NASD recognizes that the intended number of investors may change over time. Accordingly, the firm would be required to disclose the intended number of investors as of the time the disclosure is made to the investor. For example, assume a firm initially intends to borrow \$1 million by borrowing \$100,000 from ten separate investors; however, after borrowing the intended \$100,000 from one investor, the second investor decides to loan the firm \$500,000. Under this scenario, the firm would be required to disclose to the first and second investors its original intention to borrow \$1 million from ten investors equally; however, the firm would be required to disclose to subsequent investors its revised intention to borrow a total of \$1 million from six investors, with one investor lending \$500,000 and five investors lending \$100,000.

---

### **3. Amounts, Types, Interest Rates, and Scheduled Maturity Dates of Debt to Which the Intended Loan Will be Subordinate**

NASD also proposes to require firms to disclose the amounts, types, interest rates, and scheduled maturity dates of debt to which the intended loan will be subordinate. NASD believes that this information is important for investors in determining whether a subordination agreement is an appropriate investment and that without this information it is difficult for investors to assess the merits and risks of the investment.

### **4. For Any Subordinated Loans With Outstanding Balances, the Outstanding Balances, Interest Rates, and Scheduled Maturity Dates of Such Loans and the Number of Investors Involved**

NASD also proposes to require firms to disclose, with respect to any subordinated loans with outstanding balances, the outstanding balances, interest rates, and scheduled maturity dates of those loans and the number of investors involved. NASD believes that it is important for investors to know about the broker-dealer's other outstanding subordinated loans and the current status of those loans to aid the investor in its determination of whether to loan funds or securities to the firm. Firms would be required to include only subordinated loans with outstanding balances at the time the investor enters into the subordination agreement.

### **5. Most Recent Audited Financial Statement**

NASD believes that firms should be required to provide an investor with a copy of the firm's most recent audited financial statement before entering into a subordination agreement with that investor.<sup>9</sup> Because a subordination agreement is an investment in the broker-dealer firm, this requirement would provide the investor with a minimum amount of financial information about the firm before deciding whether to invest.

## **Request for Comment**

### **NASD requests comment on the following questions:**

- (1) Is there additional information NASD should require firms to disclose to help an investor understand the risks of a subordinated loan and whether the loan is an appropriate investment? Are any of the items NASD proposes to require firms to disclose unnecessary?
- (2) For those items requiring firms to disclose intentions (*i.e.*, intended use of proceeds and intended number of investors), should firms have an obligation to inform investors that have already invested of any change?
- (3) Should certain classes of persons be prohibited from entering into subordination agreements with firms? Should firms be obligated to ensure that investors entering into subordination agreements have a certain minimum level of sophistication or net worth? If so, what level would be appropriate?

- 
- (4) The current proposal would not require firms to make the disclosures if the investor were an “institutional account.” Is this exclusion appropriate? Are there other classes of persons that should also be excluded?
  - (5) Should NASD require firms to receive a signed acknowledgement from the investor that it has received, read, and understands the disclosures similar to the requirement for the Disclosure Document?
  - (6) The current proposal would require firms to disclose only previously provided subordinated loans if those loans have outstanding balances. Should firms be required to disclose all previously provided subordinated loans within a certain timeframe, including loans that have been paid off? If so, what would be an appropriate timeframe?

In addition to the questions listed above, NASD is interested in any other issues that commenters may wish to address relating to the proposal.

## Endnotes

- 1 See *Notice to Members* (NtM) 02-32 (June 2002).
- 2 See NtM 03-73 (Nov. 2003) (NASD Announces Online Availability of Comments). Personal identifying information, such as names or e-mail addresses, will not be edited from submissions. Persons commenting on this proposal should submit only information that they wish to make publicly available.
- 3 Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and rules thereunder.
- 4 For firms for which NASD is the DEA, the local District Office reviews and approves subordination agreements. NASD approval of subordination agreements is a regulatory function. It does not include an opinion regarding the viability or suitability of the investment.
- 5 67 Fed. Reg. 36281 (May 23, 2002); see also NtM 02-32 (June 2002).
- 6 References to “subordinated loans” in this *Notice* include arrangements under both subordinated loan agreements and secured demand note agreements.
- 7 This proposal would only apply to those firms for which NASD is the DEA. Firms would not be required to file these additional disclosures with NASD as part of the subordination agreement review process. Rather, NASD would require firms to maintain copies of these disclosures and make them promptly available to NASD staff in the ordinary course of examinations or upon request.
- 8 NASD proposes to exempt institutional accounts from this requirement. Thus, firms would not be required to provide these disclosures to investors that meet the definition of “institutional account” in NASD Rule 3110(c)(4).
- 9 This requirement would be separate from existing requirements under other rules addressing the disclosure of financial information. See, e.g., SEC Rule 17a-5(c); NASD Rule 2270.

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Continuing Education  
Legal & Compliance  
Registration  
Senior Management

## KEY TOPICS

Continuing Education  
Firm Element

## GUIDANCE

### Continuing Education

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

#### Executive Summary

The Securities Industry/Regulatory Council on Continuing Education (Council) has issued the annual Firm Element Advisory, a guide for firms to use when developing their continuing education Firm Element training plans. The Council recommends that firms use the Firm Element Advisory as part of the Firm Element Needs Analysis to help identify relevant training topics for all covered persons, including supervisors. New rules or regulations, such as the Do-Not-Call Registry; major regulatory examination findings, such as those relating to day trading; ethics and professional conduct; and any new products or services the firm plans to offer should be considered as topics for Firm Element training.

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

---

## Questions/Further Information

Questions concerning this *Notice* may be directed to Ann M. Griffith, Associate Vice President, Testing and Continuing Education, at (240) 386-5051; or Joseph McDonald, Associate Director, Testing and Continuing Education, at (240) 386-5065.

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.



The Securities Industry Continuing Education Program

[www.securitiescep.com](http://www.securitiescep.com)

## Securities Industry Continuing Education Program Firm Element Advisory

Each year the Securities Industry/Regulatory Council on Continuing Education (CE Council) publishes the Firm Element Advisory to identify current regulatory and sales practice issues for possible inclusion in Firm Element Training plans. This year's topics have been taken from a review of industry regulatory and self-regulatory organization (SRO) publications issued since the last Firm Element Advisory of September 2003.

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

The CE Council provides a convenient way for firms to access the training resources listed next to each topic in the Firm Element Advisory via the CE Council Web site at [www.securitiescep.com](http://www.securitiescep.com). By using the Search function on the site and entering the referenced document, it will be possible to review the content on the CE Web site. In addition to the Firm Element Advisory material, there are also two additional resources to assist with developing Firm Element training plans. The first is the Firm Element Organizer, available at [www.securitiescep.com/TOC/Firm\\_Element/](http://www.securitiescep.com/TOC/Firm_Element/). This is an easy-to-use software application that enables the search of an extensive database of regulatory resources related to specific investment products or services. The results of a search can then be edited into a document that will assist in developing a Firm Element training plan. A tutorial on the CE Council Web site demonstrates how to use the Firm Element Organizer. The second potential Firm Element resource is the Regulatory Element Scenario Library, available at [www.securitiescep.com](http://www.securitiescep.com)>*CEP Training Material*. The Scenario Library is comprised of scenarios that were taken from the Regulatory Element Supervisor (S201) and General (S101) programs, and may be suitable for Firm Element training.

For more information, log on to [www.securitiescep.com](http://www.securitiescep.com), or call Ann M. Griffith, Associate Vice President, NASD Testing & Continuing Education, at (240) 386-5051; or Joe McDonald, Associate Director, NASD Testing & Continuing Education, at (240) 386-5065; or Roni Meikle, Director, Continuing Education, New York Stock Exchange, at (212) 656-2156.

---

## Alternative Investments

### Non-Conventional Investments

Some alternative investments, such as asset-backed securities, distressed debt, and derivative products (collectively termed “non-conventional investments”(NCI)), often have complex terms and features that are not easily understood by investors. In selling NCIs, firms have obligations to: (1) conduct adequate due diligence to understand the features of the product; (2) perform a reasonable-basis suitability analysis; (3) perform a customer-specific suitability analysis in connection with any recommended transactions; (4) provide a balanced disclosure of both the risks and rewards associated with the particular product, especially when selling to retail investors; (5) implement appropriate internal controls; and (6) train registered persons regarding the features, risks, and suitability of these products. See *NASD Notice to Members 03-71: NASD Reminds Members of Obligations When Selling Non-Conventional Investments* (November 2003).

---

## Anti-Money Laundering

### Broker-Dealer Customer Identification Rule

Anti-money laundering is an evolving topic, as regulators adopt new rules and regulations to carry out the mandates of the USA PATRIOT Act. On April 29, 2003, the Securities and Exchange Commission (SEC or Commission) and Department of the Treasury jointly issued the broker-dealer customer identification rule (CIP Rule). The rule requires broker-dealers to implement customer identification programs that contain the following elements: (1) procedures for verifying the identities of customers, (2) procedures for maintaining records of the verification process, (3) procedures for comparing customers with lists of known or suspected terrorists or terrorist organizations, and (4) procedures for providing customers with notice that information is being collected to verify their identities. See *31 C.F.R. 103.122*.

The CIP Rule permits broker-dealers to rely on certain other financial institutions to undertake the required elements with respect to shared customers. On February 12, 2004, the SEC Division of Market Regulation staff issued a No-Action letter to the Securities Industry Association stating that the Division staff will not recommend enforcement action to the Commission under Rule 17a-8 if a broker-dealer relies on an investment adviser to perform customer identification procedures, prior to such adviser becoming subject to an Anti-Money Laundering Rule (AML Rule). Certain additional requirements and conditions in the CIP Rule must also be met, including that: (1) such reliance is reasonable under the circumstances; (2) the investment adviser is regulated by a Federal functional regulator (as defined in the CIP Rule); and (3) the investment adviser enters into a contract requiring it to certify annually to the broker-dealer that it has implemented an anti-money laundering program, and that it will perform (or its agent will perform) specified requirements of the broker-dealer’s customer identification program. This letter will be withdrawn without further action on the earlier of: (1) the date upon which an AML Rule for

---

advisers becomes effective, or (2) February 12, 2005. See *SEC Division of Market Regulation: No-Action Letter to the Securities Industry Association, February 12, 2004*. See also NASD's Anti-Money Laundering Web page at [www.nasdr.com/money.asp](http://www.nasdr.com/money.asp); and the SEC's *Spotlight On: Anti-Money Laundering Rules* at [www.sec.gov/spotlight/moneylaundering.htm](http://www.sec.gov/spotlight/moneylaundering.htm). See also *NYSE Information Memos 03-48, Rule 445 – Initial Anti-Money Laundering Audit, October 23, 2003*, and *03-32, Customer Identification Programs for Broker-Dealers, July 14, 2003* at [www.nyse.com/regulation/information/memos](http://www.nyse.com/regulation/information/memos).

---

## Bond Sales

### Sales Practice Obligations

As the number of retail customers investing in bonds and bond funds grows, regulators are concerned that many investors may not fully appreciate the risks and costs associated with such products. It is the responsibility of firms to take appropriate steps to ensure that their registered representatives understand and inform their customers about the characteristics and risks as well as the rewards of the products they offer and recommend. Firms have the following obligations in connection with the sale of bonds and bond funds:

1. Understanding the terms, conditions, risks, and rewards of the bonds and bond funds they sell (performing a reasonable-basis suitability analysis);
2. Making certain that a particular bond or bond fund is appropriate for a particular customer before recommending it to that customer (performing a customer-specific suitability analysis);
3. Providing a balanced disclosure of the risks, costs, and rewards associated with a particular bond or bond fund, especially when selling to retail investors;
4. Adequately training and supervising employees who sell bonds and bond funds; and
5. Implementing adequate supervisory controls to reasonably ensure compliance with NASD and SEC sales practice rules in connection with bonds and bond funds.

See *NASD Notice to Members 04-30: NASD Reminds Firms of Sales Practice Obligations In The Sale of Bonds and Bond Funds* (April 2004).

continued

---

### Mark-Ups

NASD recently levied \$15 million in total fines against four firms for rule violations relating to trading in corporate high-yield bonds. All four firms were cited for charging excessive markups or markdowns, inadequate record keeping and supervision violations. Firms are reminded that they must sell all securities, including corporate high-yield debt, at fair prices. Markups and markdowns generally should not exceed five percent and, for most debt transactions, that figure should be lower.

---

### Business Continuity Plans

On April 7, 2004, the SEC approved new rules pertaining to firms' emergency preparedness and business continuity planning. The rules require firms to, among other things, establish and maintain business continuity plans and, upon request, to provide summaries of such plans to their customers. The rules also require firms to designate two emergency contact persons and to provide this information to NASD or NYSE. NASD Rule 3510 became effective for clearing firms on August 11, 2004, and on September 10, 2004 for introducing firms. NASD Rule 3520 became effective for all firms on June 14, 2004. NYSE Rule 446 became effective August 5, 2004 for all members and member organizations. See *NASD Notice to Members 04-37: SEC Approves Rules Requiring Members to Create Business Continuity Plans and Provide Emergency Contact Information* (May 2004). See also NASD's Business Continuity Plan Web page at [www.nasdr.com/business\\_continuity\\_planning.asp](http://www.nasdr.com/business_continuity_planning.asp). See also *NYSE Information Memo 04-24, Rule 446 – Business Continuity and Contingency Plans, May 3, 2004*.

---

### Continuing Education

NASD Rule 1120 and NYSE Rule 345A set forth the CE requirements for registered persons. The CE requirements consist of a Regulatory Element and a Firm Element. NASD provides members with e-mail notifications through the Web Central Registration Depository® (Web CRD®) when a person is both 90 days and 30 days away from the end of his or her period to complete the Regulatory Element program before going inactive. Web CRD also notifies members when a registered person at the firm becomes CE inactive. Receipt of the e-mail notifications had been optional, and some firms chose not to receive the notifications. On February 13, 2004, the SEC approved amendments to NASD Rule 1120 to require that each member designate and identify to NASD the individual(s) who will receive the Web CRD Continuing Education Regulatory Element e-mails. See *NASD Notice to Members 04-22: SEC Approves Amendments to Rule 1120 (Continuing Education Requirements) Regarding Regulatory Element Contact Person* (March 2004).

---

---

The SEC has approved NASD and NYSE rule filings to eliminate all exemptions from the requirement to complete the Regulatory Element of the Continuing Education Program. The Securities Industry/Regulatory Council on Continuing Education unanimously agreed at its December 2003 meeting to recommend to the self-regulatory organizations (SROs) that they repeal the current exemption for industry members who, when the Continuing Education Program was adopted in 1995, had been registered for at least 10 years and who did not have a significant disciplinary action during that time (“grandfathered” persons) and registered persons who had “graduated” from the Regulatory Element by satisfying their tenth anniversary requirement before July 1998. The rule changes will become effective no later than April 4, 2005. The other SROs are also seeking approval of the same rule change from the SEC. See *Securities Exchange Act Release Nos. 34-50404* (September 16, 2004) (NYSE Approval Order) and *50456* (September 27, 2004) (NASD Approval Order).

---

## Customer Account Transfers

On March 12, 2004, the SEC approved amendments to NYSE Rule 412 (Customer Account Transfer Contracts) and its interpretation. An effective date of September 12, 2004 was established for full compliance with the amendments to allow member organizations sufficient time to develop and implement any necessary systems changes.

Rule 412 prescribes procedures for transferring customer accounts between member organizations. The rule also generally requires use of the Automated Customer Account Transfer Service (ACATS) system for full account transfers, when both the delivering and receiving organizations are members of the National Securities Clearing Corporation (NSCC) which administers the ACATS system.

The amendments:

- (1) Mandate use of the ACATS system for “partial” transfers, unless otherwise specifically requested and authorized by a customer;
- (2) Require the utilization of all automated functionalities available through the ACATS system in connection with both standard and partial transfers and
- (3) Clarify that electronic signatures are a potential means of customer authorization and clarify certain designated exceptions to transfer instructions.

See *NYSE Information Memo 04-20, Amendments to Rule 412 (“Customer Account Transfer Contracts”) and Its Interpretation, April 8, 2004*; and *NYSE Interpretation Memo, 04-02, April 20, 2004*. See also *NASD Notice to Members 04-58: SEC Grants Accelerated Approval of Rule Change Relating to Transfers of Specifically Designated Customer Account Assets through the Automated Customer Account Transfer Service (ACATS)* (August 2004).

---

## Data Retention

On April 29, 2004, the SEC approved amendments to NASD rules to require members to record and report execution price and firm capacity as part of their Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>) Execution Reports. See *NASD Notice to Members 04-48: SEC Approves Amendments to Rule 6954 Requiring Members to Record and Report Execution Price and Firm Capacity in OATS Execution Reports* (June 2004). See also *NYSE Information Memos 03-37, Order Tracking System Technical Specifications; Exchange Rules 132A, 132B and 132C, September 10, 2003 and 03-51, Clarification to Information Memo No. 03-18 re: Books and Records Requirements for Floor Brokers Who Conduct a Public Business – Exchange Rules 36, 123 and 440, November 10, 2003.*

---

## Day Trading

Day trading is the buying and selling of, or selling short and buying to cover, the same security on the same day. NASD recently levied \$10 million in total fines against three firms for improperly extending credit in violation of Federal Reserve Board Regulation T, and, in numerous instances, allowing trades that avoided industry day trading margin requirements.

Regulation T Section 220.8(a)(1) states that a broker-dealer may use a cash account to buy a security for a customer if: (1) there are sufficient funds in the account; or (2) the creditors accept in good faith the customer's agreement that the customer will promptly make full cash payment for the security or asset before selling it and does not contemplate selling it prior to making such payment.

Federal Reserve Board interpretations make clear that a customer who sells a security in a cash account on trade date to pay for another security purchased on that day does not have "sufficient funds in the account" on trade date for purposes of Regulation T Section 220.8(a)(1)(i). Rather, a customer must make full payment for each separate purchase transaction in a cash account without regard to the unsettled proceeds of securities sold. If a member firm plans to accept the unsettled proceeds of a securities sale as payment for securities purchased, the transaction must be conducted in a margin account and is subject to the regulations affording protection to customers who trade in margin accounts. See *NASD Notice to Members 04-38: NASD Reminds Member Firms of Their Obligations to Adhere to Credit Extension Requirements and Day Trading Margin Rules* (May 2004). See also NASD Rule 3520 and NYSE Rule 431.

---

## Do-Not-Call Registry

On January 12, 2004, the SEC approved amendments to NASD Rule 2212 (Telemarketing) and Rule 3110 (Books and Records). These amendments set forth NASD's requirement that member firms participate in the Federal Trade Commission's national do-not-call registry. See *NASD Notice to Members 04-15: SEC Approves Amendments to NASD Rules Concerning Member Participation in the National Do-Not-Call Registry* (March 2004). See also NYSE Rule 440A.

---

---

## Ethics

The CE Council will introduce an ethics module as part of the Regulatory Element of the CE Program in early 2005; nonetheless, firms should address ethical issues in their own Firm Element training. Such individual programs can tailor general concepts to the values, policies, culture, organization and business model of the particular firm, and allow senior management to participate in the ethics program, thereby modeling and articulating the firm's commitment to high ethical standards in daily business conduct.

Ethics programs should do more than explain industry rules and firm policies. They should provide a context for regulatory requirements by addressing the importance of upholding the firm's values (e.g., integrity, trustworthiness), what *constitutes* the "right" thing, and the spirit—not only the letter—of the law. They should also help employees develop a greater awareness of ethics issues and a stronger ability to make ethical decisions, including dealing with organizational influences on such decision-making. Such programs should be based on the firm's code of ethics (if any), its supervisory procedures, mechanisms for reporting observed misconduct, and other policies that bear on the conduct of its employees—and they should be realistic.

The firm's annual needs assessment should seek to identify ethical dilemmas that employees face (or see their colleagues facing), as well as pressures that may keep employees from acting properly or reporting their ethical concerns. The assessment process might include obtaining feedback from business units, staff functions (human resources, employee relations, legal, compliance, audit, security), as well as employees themselves. Assessments can be based on direct interviews, document review, employee questionnaires, or a combination of techniques including the use of confidential surveys or third parties that often encourage employees to respond candidly.

Depending on the firm's business and structure, the needs assessment may reveal ethics issues such as (A) conflicts of interest (e.g., personal trading, outside activities, gifts/gratuities/entertainment, political contributions), (B) relationships with other employees (e.g., dignity and respect, sexual harassment, discrimination), (C) relationships with customers (e.g., putting the client's best interests first, dealing with improper requests from customers), and (D) representing the firm's interests (e.g., using firm property, accuracy of records, responding to regulatory inquiries). The assessment may also indicate that ethical conduct is especially challenging in an organization due to such influences as peer pressure, lack of information, rationalizations (e.g., believing that one can hold the line after making only one exception, or that one's supervisor would never make an improper request), or "bottom line" pressures.

continued

---

The ethics curriculum should include ethical situations (cases), approaches to resolving such dilemmas and strategies and resources for dealing with organizational influences (e.g., focusing on long-term success instead of short-term expediency, using confidential help lines). Rather than providing ethical content in isolation, firms should have employees apply ethical principles to realistic fact patterns, hear stories of people who have made the wrong ethical decision and those who have had the courage to make the right choice, and consider the consequences of ethical decisions for customers, employees, the firm, and the industry (especially with regard to investor confidence and integrity of the firm). Firms should bear in mind that experience often varies dramatically among employees of the same firm, or between supervisors and staff, and that the training needs may differ across the firm.

There are a variety of methods to deliver stimulating ethics training, including provision of instruction in person (utilizing outside experts, train-the-trainer methodologies, or in-house personnel), and electronic means. Group interaction is particularly useful in ethics training. Instead of merely providing reading material or lectures, firms should engage employees by providing an opportunity (whether online, in small discussion groups or both) by which employees can express their views and hear the views of their colleagues.

---

### Fee-Based Compensation

Fee-based compensation programs typically charge a customer a fixed fee or percentage of assets under management in lieu of transaction-based commissions. Broker-dealers are reminded that they must have reasonable grounds for believing that a fee-based program is appropriate for a particular customer, taking into account the services provided, cost, and customer preferences. It is generally inconsistent with just and equitable principles of trade—and therefore a violation of SRO Rules—to place a customer in an account with a fee structure that reasonably can be expected to result in a greater cost than an alternative account offered by the member that provides the same services and benefits to the customer. See *NASD Notice to Members 03-68: NASD Reminds Members That Fee-Based Compensation Programs Must Be Appropriate* (November 2003), and related Questions and Answers on NASD's Web site. See also proposed NYSE Rule 405A, SR-NYSE-2004-13.

---

### Floor Communications

Members and member organizations of the NYSE are required to adhere to various requirements when conducting a public business from the NYSE trading floor. Such requirements include supervision, registration, employment, financial, operations, sales practices, and record retention. See *NYSE Information Memos 03-54: Reminder Regarding Requirements for Conducting a Public Business on the Trading Floor; Floor Communications, November 25, 2003*, and *01-41: Requirements for Conducting a Public Business on the Trading Floor; Floor Communications, November 21, 2001*.

---

## Hedge Funds

Hedge funds pool investors' money and invest those funds in financial instruments in an effort to make a positive return. Many hedge funds seek to profit in all kinds of markets by pursuing leveraging and other speculative investment practices that may increase the risk of investment loss. Hedge funds are not currently registered with the SEC.

The SEC has proposed for comment a new rule and rule amendments under the Investment Advisers Act of 1940 (Advisers Act). The proposed new rule and amendments would require advisers to certain hedge funds to register with the SEC under the Advisers Act. The rule and rule amendments are designed to provide the protections afforded by the Advisers Act to investors in hedge funds and to enhance the SEC's ability to protect the securities markets. See *SEC Release No. IA-2266, Registration Under the Advisers Act of Certain Hedge Fund Advisers, July 20, 2004*; and *SEC Investor Tips: Hedging Your Bets*. See also the SEC's Hedge Fund Web site at [www.sec.gov/spotlight/hedgefunds.htm](http://www.sec.gov/spotlight/hedgefunds.htm) and *NASD Notice to Members 03-07: NASD Reminds Members of Obligations When Selling Hedge Funds* (February 2003).

---

## Internal Controls

On June 17, 2004, the SEC approved amendments to NYSE Rules 342, 401, 408, and 410 to strengthen the supervisory procedures and internal controls of members and member organizations. To allow sufficient time for adoption and establishment of necessary systems changes, an effective date of December 17, 2004 has been set for compliance with the amendments. However, good business practice suggests compliance as soon as possible.

The amendments prescribe general standards with respect to internal controls, including the regulatory systems and procedures and their purpose regarding supervision and control, business conduct, discretionary accounts, and records of orders. See *NYSE Information Memo 04-38, Amendments to Rules 342, 401, 408 and 410 Relating to Supervision and Internal Controls, July 26, 2004. Effective date December 17, 2004*. See also *NYSE Disciplinary Actions 04-128*, dated August 2, 2004, and *02-227, 02-226, 02-225, 02-224, 02-223*, all dated November 15, 2002, regarding e-mail retention.

On June 17, 2004, the SEC approved rule changes (Supervisory Control Amendments) by NASD that both create and amend certain rules and interpretive materials to address a member's supervisory and supervisory control procedures. On September 30, 2004, the SEC granted accelerated approval to proposed rule changes to the Supervisory Control Amendments to conform certain parts of the new rule requirements to the NYSE's recently approved internal control amendments. See *NASD Notice to Members 04-71: SEC Approves New Rules and Rule Amendments Concerning Supervision and Supervisory Controls; Effective date January 31, 2005* (October 2004).

continued

---

The SEC has also adopted new rules under the Investment Company Act of 1940, and the Advisers Act, that require each investment company and investment adviser registered with the SEC to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws. Firms must review these policies and procedures annually for their adequacy and designate a chief compliance officer to be responsible for administering the policies and procedures. In the case of an investment company, the chief compliance officer reports directly to the fund board. These rules are designed to protect investors by ensuring that all funds and advisers have internal programs to enhance compliance with the federal securities laws. See *SEC Release No. IA-2204, Compliance Programs of Investment Companies and Investment Advisers, December 17, 2003. Effective Date: February 5, 2004.*

---

## Margin

The SEC approved revisions to NYSE Rule 431 and NASD Rule 2520. These amendments provide for margin requirements on non-equity securities commensurate with the economic risks associated with positions in such securities held by customers. The reduced margin requirements recognize both the quality of the securities and the creditworthiness of the customer and therefore preserve reasonable safety and soundness standards. The types of non-equity securities eligible for exempt account treatment have been expanded. See *NYSE Information Memos 03-42, Amendments to Rule 431 ("Margin Requirements") Regarding "Good Faith" Securities, September 29, 2003, and 03-46, Correction to Information Memo No. 03-42, October 10, 2003. See also NASD Notice to Members 03-66: Amendments to NASD Rules Regarding Margin Requirements (October 2003).*

---

## Municipal Securities

### Consultants

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

See MSRB Rule G-38 in the *MSRB Rule Book* and online at [www.msrb.org](http://www.msrb.org).

---

### **Municipal Fund Securities**

Municipal fund securities, including 529 college savings plans, are municipal securities regulated by the MSRB. Municipal fund securities represent investments in pools of securities, such as securities issued by registered investment companies. Therefore, certain sales materials for municipal fund securities must comply with the advertising rules of the SEC and NASD, including NASD Rule 2210. Principals supervising the sale of municipal fund securities must be appropriately qualified and hold either a Series 51 (Municipal Fund Securities Limited Principal) or Series 53 (Municipal Securities Principal) license. For more information, see the section on Municipal Fund Securities on the MSRB Web site at [www.msrb.org/msrb1/mfs/default.asp](http://www.msrb.org/msrb1/mfs/default.asp). See also *NASD Notice to Members 03-17: Sales Material for Municipal Fund Securities* (March 2003); and *NASD Issues Investor Alert on 529 College Savings Plans, September 13, 2004* at [www.nasdr.com/news/pr2004/release\\_04\\_059.html](http://www.nasdr.com/news/pr2004/release_04_059.html), a news release regarding expenses and tax incentives associated with investments in 529 college savings plans.

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

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

The MSRB published a notice indicating its concern with increasing signs that individuals subject to Rule G-37 may be using indirect political contributions in an attempt to get around the rule. This would be accomplished through: (1) payments to political parties or non-dealer controlled PACs that find their way to issuer officials, (2) significant political contributions by dealer affiliates to both issuer officials and political parties, (3) contributions by associated persons of the dealer who are not MFPs, (4) contributions by the spouses and family members of MFPs to issuer officials, and (5) the use of consultants who make or bundle political contributions. The MSRB reminded dealers that Rule G-37, as currently in effect, covers indirect as well as direct contributions to issuer officials, and the MSRB alerted dealers that it has expressed its concern to the entities that enforce the MSRB's rules that some of the increased political giving may indicate a rise in Rule G-37 violations from "indirect" contributions. See *Notice Concerning Indirect Rule Violations: Rules G-37 and G-38* (August 6, 2003), MSRB Rule Book.

continued

---

## **Municipal Securities Transaction Reporting**

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

Firms may need to adapt their procedures and systems for processing municipal securities transactions in order to report their trades in real time by January 2005. The MSRB has filed a proposed rule change with the SEC regarding Rule G-14 on transaction reporting, Rule G-12(f) on automated comparison of inter-dealer transactions, and the implementation of a system for real-time transaction reporting and price dissemination (the Real-Time Transaction Reporting System or RTRS). The proposed changes would require broker-dealers to report nearly all transactions in municipal securities within 15 minutes of the time of trade execution instead of by midnight on trade date, as is currently required. Broker-dealers would also be required to submit inter-dealer transactions to the central comparison system within the same time frame. The proposed rule change is planned to become effective in January 2005, at which time the MSRB would begin to disseminate transaction data electronically in real-time immediately after receipt.

Adapting to real-time reporting will require that a firm's traders provide several more data items for transaction processing than what currently is provided. An example of a new data item is the firm's capacity in an inter-dealer trade, whether as principal or as agent for a customer. All information must be provided accurately and within a short time frame. The MSRB will publish a user manual for real-time trade reporting in the second half of 2004 to assist in identifying necessary changes and to aid in staff training.

See the Transaction Reporting System section of the MSRB Web site, [www.msrb.org](http://www.msrb.org). In particular, see *MSRB Notice 2004-13, Notice of Filing of Proposed Rule Change to Rules G-14 and G-12(f)* (June 1, 2004); *MSRB Notice 2004-20, Summary of Certification Test Plan* (June 24, 2004); *MSRB Notice 2004-21, MSRB Will Make Form RTRS Available On-Line* (June 24, 2004); and *MSRB Notice 2004-29, Approval by the SEC of Real-Time Transaction Reporting and Price Dissemination* (September 2, 2004).

---

### Dealer Pricing Responsibilities

The MSRB published a notice reviewing the fair pricing requirements of MSRB Rules G-18 and G-30, including a review of the responsibility of broker's brokers to use a "reasonable effort" to find a price that is fair and reasonable in light of the prevailing market. The MSRB notice reviews the Rule G-18 and G-30 application in light of the MSRB's review of certain transaction patterns that have appeared in the MSRB's Transaction Reporting System. The patterns, which show abnormally large price variance in a relatively small number of issues each day, suggest that brokers, dealers, and municipal securities dealers may not always be making the requisite efforts to ensure that transaction prices are reasonably related to market value. See *MSRB Notice 2004-3, Review of Dealer Pricing Responsibilities* (January 26, 2004)

---

### Mutual Funds

The following types of mutual fund transactions are under increased scrutiny from regulators.

#### Breakpoint Discounts

Breakpoint discounts are volume discounts applicable to front-end sales charges on Class A mutual fund shares (front-end loads). The SEC and SROs determined that many investors were not receiving correct breakpoint discounts on their mutual fund purchases. It was estimated that at least \$86 million was owed to investors for 2001 and 2002 alone. Firms must disclose applicable breakpoint discount information to their customers and must have procedures reasonably designed to ascertain information necessary to determine the availability and appropriate level of breakpoints. Failure to provide customers with appropriate breakpoint discounts is conduct in violation of Section 17(a)(2) of the Securities Act of 1933, NASD Rule 2110 and NYSE Rule 401. See NASD's Mutual Fund Breakpoints Web page at [www.nasdr.com/breakpoints\\_members.asp](http://www.nasdr.com/breakpoints_members.asp); *NASD Investor Alert Net Asset Value Transfers: Look Before You Leap Into Another Mutual Fund, February 26, 2004*; NASD's Mutual Fund Sales Practices Web page at [www.nasdr.com/mutual\\_funds.asp](http://www.nasdr.com/mutual_funds.asp); and the SEC's Breakpoints Web site at [www.sec.gov/spotlight/breakpoints.htm](http://www.sec.gov/spotlight/breakpoints.htm).

The Joint NASD/Industry Breakpoint Task Force developed recommendations to facilitate the complete and accurate delivery of breakpoint discounts in the future. The Task Force Report, which is available at [www.nasdr.com/breakpoints\\_report.asp](http://www.nasdr.com/breakpoints_report.asp), made recommendations that will impact virtually every level of the mutual fund distribution chain. See also [www.nasdr.com/breakpoints\\_members.asp](http://www.nasdr.com/breakpoints_members.asp) (which reports the implementation status of Task Force recommendations).

continued

---

### **Late Trading Transactions**

Late trading is the practice of placing mutual fund orders received after the time at which point the fund calculates its daily net asset value (NAV)—usually 4 p.m. ET—at the previous day's NAV price. Late trading also includes the after-close cancellations of orders that were placed prior to the time a fund calculates the NAV. Firms that permit late trading provide customers with an unfair information advantage, allowing them to trade based on news that breaks after the close of the market. NASD Rules 2110 and 2120 and SEC rules prohibit late trading.

There are situations where firms legitimately receive orders prior to the close of trading, but enter such orders after the market's close. Firms should take great care to ensure that these trades are executed at the appropriate price. Firms must have in place policies and procedures that are reasonably designed to detect and prevent the occurrence of late trading. *See NASD Notice to Members 03-50: NASD Reminds Member Firms of their Obligations Regarding Mutual Fund Transactions and Directs Review of Policies and Procedures* (September 2003). *See also* the following NASD news release: *NASD Fines Five Firms \$625,000 For Supervisory System Failures Relating to Late Trading of Mutual Funds* (June 24, 2004).

### **Market Timing Transactions**

Market timing is the rapid buying and selling of mutual funds (funds). In some cases, market timers pace their orders to profit from short-term inaccuracies in the NAV of the fund. Many funds have implemented procedures to counteract the efforts of market timers, and have represented in their prospectuses that they are utilizing these procedures to prevent market timing of the fund.

When a fund has made these representations, a member firm and its associated persons may not knowingly or recklessly act in conjunction with the fund, or its affiliated persons, to facilitate a market timing transaction. In addition, member firms must have in place policies and procedures that are reasonably designed to prevent this collusion with funds and their affiliated persons to circumvent the funds' stated procedures. *See NASD Notice to Members 03-50: NASD Reminds Member Firms of their Obligations Regarding Mutual Fund Transactions and Directs Review of Policies and Procedures* (September 2003). *See also* the following NASD news release: *NASD Fines State Street Research Investment Services \$1 Million For Market Timing Supervision Violations; Firm Ordered to Pay More than \$500,000 in Restitution* (February 19, 2004).

---

## New and Secondary Offerings

The SEC has approved a number of new NASD rules and amendments to remedy inequities in public offerings.

### **Restrictions on the sale of new issues**

Rule 2790 generally prohibits a member from selling a "new issue" to any account in which a "restricted person" has a beneficial interest. The term "restricted person" includes most associated persons of a member, most owners and affiliates of a broker-dealer, and certain other classes of persons. The rule requires that a member, before selling a new issue to any account, meet certain "preconditions for sale." These generally require the member to obtain a representation from the beneficial owner of the account that the account is eligible to purchase new issues in accordance with the rule. See *NASD Notice to Members 03-79: SEC Approves New Rule 2790 (Restrictions on the Purchase and Sale of IPOs of Equity Securities); Replaces Free-Riding and Withholding Interpretation* (December 2003).

### **Restrictions on Underwriting Compensation**

On December 23, 2003, the SEC approved amendments to Rule 2710 (Corporate Financing Rule). The Corporate Financing Rule regulates underwriting compensation and prohibits unfair arrangements in connection with the public offerings of securities. The rule requires members to file information about initial public offerings and certain secondary offerings with NASD. The NASD Corporate Financing Department reviews this information prior to commencement of the offering to determine whether the underwriting compensation and other terms and arrangements meet the requirements of applicable NASD rules. As amended, Rule 2710(c)(3)(A) sets forth a non-exclusive list of specific types of "items of value" that will be included for purposes of determining the amount of underwriting compensation received or to be received. Rule 2710(c)(3)(B), in turn, provides a list of items that will not be considered "items of value" for purposes of the rule. See *NASD Notice to Members 04-13: SEC Approves Amendments to Rule 2710 (Corporate Financing Rule) and Rule 2720 (Distribution of Securities of Members and Affiliates-Conflicts of Interest)* (February 2004).

NASD Rule 2810 (Direct Participation Programs), among other things, establishes limits on the level of underwriting compensation for public offerings of direct participation programs. In a change of policy, NASD staff will consider all trail commissions paid in connection with commodity pool direct participation programs in calculating whether the level of underwriting compensation meets the requirements of Rule 2810. See *NASD Notice to Members 04-50: Treatment of Commodity Pool Trail Commissions under Rule 2810 (Direct Participation Programs Rule)* (July 2004).

---

## Registered Representative Regulations

### Lending Restrictions

On August 29, 2003, the SEC approved the adoption of NASD Rule 2370, prohibiting registered persons from borrowing money from, or lending money to, a customer unless: (1) the member has written procedures allowing such lending arrangements consistent with the rule; (2) the loan falls within one of five prescribed permissible types of lending arrangements set forth in the rule; and (3) the member pre-approves the loan in writing. On February 18, 2004, the SEC approved amendments to NASD Rule 2370 exempting from the rule's notice and approval requirements lending arrangements involving a registered person and a customer that is: (1) a member of his or her immediate family (as defined in the rule); or (2) a financial institution regularly engaged in the business of providing credit, financing, or loans (or other entity or person that regularly arranges or extends credit in the ordinary course of business), provided the loan has been made on commercial terms that the customer generally makes available to members of the general public similarly situated as to need, purpose, and creditworthiness. The amendments to Rule 2370 also limit the scope of the rule to lending arrangements between registered persons and their customers, rather than any customer of the firm. See *NASD Notice to Members 04-14: SEC Approves Amendments to Rule Governing Lending Between Registered Persons and Customers* (March 2004). See also proposed amendment to NYSE Rule 350 (SR-NYSE-2004-47).

---

## Reporting and Disclosure Requirements

On June 14, 2004, the SEC approved amendments to NASD Rule 6230(a) of the Trade Reporting and Compliance Engine (TRACE) Rules (the Rule 6200 Series), reducing the period for reporting a transaction to NASD. In the first stage, which began on October 1, 2004, the period to report a transaction in a TRACE-eligible security was reduced from 45 minutes to 30 minutes. In the second stage, set to begin July 1, 2005, the reporting period will be reduced to 15 minutes. See *NASD Notice to Members 04-51: SEC Approves Amendments to TRACE Rule 6230 to Reduce the Reporting Period to 30 Minutes on October 1, 2004, and to 15 Minutes on July 1, 2005* (July 2004).

On September 3, 2004, the SEC approved amendments to NASD Rules 6210, 6250, and 6260 of the TRACE Rules. The most significant amendments, which are set forth in NASD Rule 6250, effect a fundamental change in the corporate bond markets by requiring that information on all transactions in TRACE-eligible securities be disseminated, except those transactions in TRACE-eligible securities that are issued pursuant to Section 4(2) of the Securities Act of 1933 (Securities Act) and purchased or sold pursuant to Rule 144A under the Securities Act. See *NASD Notice to Members 04-65: SEC Approves Amendments to TRACE Rules to Disseminate Transaction Information on All TRACE-Eligible Securities, Modify and Supplement Defined Terms, and Enhance Notification Requirements* (September 2004).

---

## Research Analyst

### **New Qualification Requirements for Research Analysts**

Effective March 30, 2004, the SEC approved amendments to NASD and NYSE rules to implement the research analyst registration requirements and examination program. Any associated person who functions as a research analyst must pass the new Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption or waiver. There is no grandfathering provision for this new qualification requirement. Research analysts will be subject to Regulatory Element and Firm Element training. Firm Element training for research analysts and their immediate supervisors will be required to include ethics, professional responsibility, and the requirements of the new research analyst rules. See *NASD Notice to Members 04-25: SEC Approves New NASD Research Analyst Qualification and Examination Requirements (Series 86/87) (March 2004)*. See also *NYSE Information Memos 04-16, Research Analyst Qualification Examination ("Series 86/87") and Registration Requirements, March 31, 2004; 04-05, Study Outline for Research Analyst Qualification Examination ("Series 86/87"), February 3, 2004; and 03-61, Rule 344 – Research Analyst Qualification Examination Requirement ("Series 86/87"), December 31, 2003*.

### **Conflicts of Interest**

In March of 2004, NASD and the NYSE issued a joint memorandum providing interpretation of rules governing research analysts and research reports. The memorandum defines the terms "research report" and "public appearance," and clarifies required research analyst disclosures, trading restrictions, and the applicability of the "significant news or event" exception to blackout period publishing restrictions. The memorandum is available in *NASD Notice to Members 04-18: NASD and NYSE Provide Further Guidance on Rules Governing Research Analysts' Conflicts of Interest (March 2004)*. See also *NYSE Information Memos 04-11, April 1st Reporting Requirement – Attestations – Rules 351 and 472, March 9, 2004; 04-10, Amendments to Disclosure and Reporting Requirements, March 9, 2004; 04-03, Extension of Effective Dates for Certain Provisions of Rule 472 ("Communications with the Public") and Rule 344 ("Research Analysts and Supervisory Analysts"), January 20, 2004; and 03-36, Rule 472 – Amendments to Disclosure and Reporting Requirements, August 25, 2003*.

---

## Short Sales

On July 28, 2004, the SEC adopted new Regulation SHO, under the Securities Exchange Act of 1934. Regulation SHO will provide a new regulatory framework governing short selling of securities. Among other things, Regulation SHO:

1. Requires broker-dealers to mark sales in all equity securities "long," "short," or "short exempt";
2. Includes a rule that suspends temporarily the operation of the current "tick" test and any short sale price test of any exchange or national securities association, for specified securities;
3. Requires short sellers in all equity securities to locate securities to borrow before selling;
4. Imposes additional delivery requirements on broker-dealers for securities in which a substantial number of failures to deliver have occurred.

Within Regulation SHO, the SEC is also: (1) adopting an amendment that removes the shelf offering exception in Rule 105 of Regulation M; (2) issuing interpretive guidance addressing sham transactions designed to evade Regulation M; (3) deferring consideration of the proposal to replace the current "tick" test with a new uniform bid test restricting short sales to a price above the consolidated best bid; and (4) deferring consideration of the proposed exceptions to the uniform bid test.

The SEC is deferring further action on the proposals mentioned in (3) and (4) of the preceding paragraph until after the completion of the pilot program established by Regulation SHO. There is no set end date for the pilot program, which will need a separate SEC order to be terminated, and will last "only as long as [is] absolutely necessary to allow the [SEC] to gather sufficient data."

See *SEC Release No. 34-50103, Short Sales, July 28, 2004*. See also the SEC's Short Sale Web site at [www.sec.gov/spotlight/shortsales.htm](http://www.sec.gov/spotlight/shortsales.htm). The effective and compliance dates for Regulation SHO vary. For example, certain interpretive material under Regulation M went into effect on August 6, 2004. Rule 105 of Regulation M became effective on September 7, 2004. The compliance date for the suspension of the tick test and locate and delivery requirements is January 3, 2005.

---

Industry rules require that no member or associated person shall effect a short sale order for any customer in any security unless the member or associated person makes an affirmative determination that the member will receive delivery of the security from the customer, or that the member can borrow the security on behalf of the customer by the settlement date. The SEC has approved amendments to Rule 3370 that expand the scope of the affirmative determination requirement to include orders received from non-member broker-dealers. See *NASD Notice to Members 04-03: SEC Approves NASD Rule Proposal Requiring Members to Make Affirmative Determinations for Short Sale Orders Received from Non-Member Broker-Dealers* (January 2004). See also *NASD Notice to Members 04-08: Effective Date of Amendments to NASD Rule 3370 (Affirmative Determination Requirements) Extended to April 11, 2004* (February 2004), and *NASD Notice to Members 04-21: NASD Provides Further Guidance on Amendments to NASD Rule 3370—Affirmative Determination Requirements* (March 2004). See also *NYSE Rules 440B, Short Sales and 440C, Deliveries Against Short Sales, and NYSE Information Memo 04-39, Expiration of Short Exemption (Exchange Rule 440BISEC Rule 10a-1), August 2, 2004*.

NASD clarified that under Rule 6130, a “short sale” or “short sale exempt” indicator is required in all short-sale transactions reported to the Automated Confirmation Transaction Service (ACT), including transactions in: (1) NASDAQ National Market securities; (2) NASDAQ SmallCap securities; (3) over-the-counter (OTC) transactions in exchange listed securities; (4) OTC Bulletin Board; and (5) OTC equity securities. See *NASD Notice to Members 04-40: NASD Clarifies ACT Short Sale Reporting Requirements* (May 2004).

---

## Unit Investment Trusts

Unit Investment Trusts (UITs) are investment companies that offer redeemable shares, each of which represents an undivided interest in a unit of specified securities. Most UITs terminate on a specified date. In addition, many UITs offer sales charge discounts based on the amount invested. Accordingly, firms have the same duty to understand, inform customers about, and correctly apply price breaks in the sale of UITs that they have with regard to breakpoint discounts in the sale of Class A mutual fund shares. They should develop and implement the same type of procedures for ensuring the proper application of such discounts in connection with the sale of mutual funds. See *NASD Notice to Members 04-26: NASD Reminds Members of Their Duty to Ensure Proper Application of Discounts in Sales Charges to Sales of Unit Investment Trusts (UITs)* (March 2004).

---

### To Obtain More Information

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

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

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Legal & Compliance  
Registered Representatives  
Senior Management

## KEY TOPICS

Article V, Section 3(a) of the NASD By-Laws  
Form U5 (Uniform Termination Notice for Securities Industry Registration)  
Interpretive Material 9216 (IM-9216)  
Minor Rule Violation Plan  
MRVP

## GUIDANCE

### Failure to Timely Submit Amendments to Form U5

SEC Announces Approval of Amendment to NASD's Minor Rule Violation Plan (MRVP) to Include Failure to Timely Submit Amendments to Form U5; **Effective Date: November 22, 2004**

#### Executive Summary

On September 24, 2004, the Securities and Exchange Commission (SEC) approved an amendment to IM-9216 (NASD's MRVP) to include the failure to timely submit amendments to Forms U5 (Uniform Termination Notices for Securities Industry Registration).<sup>1</sup>

#### Questions/Further Information

Questions concerning this *Notice* may be directed to Shirley H. Weiss, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8844.

#### Background

In 1984, the SEC adopted amendments to SEC Rule 19d-1(c) under the Securities Exchange Act of 1934 to allow self-regulatory organizations to adopt, with SEC approval, plans for the disposition of minor violations of rules.<sup>2</sup> In 1993, pursuant to SEC Rule 19d-1(c), NASD established an MRVP, as set forth in NASD Rule 9216(b).<sup>3</sup> In 2001, the SEC approved significant amendments to NASD's MRVP.<sup>4</sup> On September 24, 2004, the SEC approved an amendment to include in NASD's MRVP the failure to timely submit amendments to Forms U5, which is the subject of this *Notice*.<sup>5</sup>

---

The purpose of the MRVP is to provide for a meaningful sanction for a minor or technical violation of a rule when the initiation of a disciplinary proceeding through the formal complaint process would be more costly and time-consuming than would be warranted. Inclusion of a rule in NASD's MRVP does not mean it is an unimportant rule; rather, it means that a minor or technical violation of the rule may be appropriate for disposition under the MRVP. NASD retains the discretion to bring full disciplinary proceedings for the violation of any rule listed in the MRVP.

Rule 9216(b) authorizes NASD to impose a fine of \$2,500 or less on any member or associated person of a member for a violation of any of the rules specified in IM-9216. NASD staff reviews the number and seriousness of the violations, as well as the previous disciplinary history of the respondent to determine if a matter is appropriate for disposition under the MRVP and to determine the amount of the fine. Once NASD has brought a minor violation of a rule against an individual or member firm, NASD may, at its discretion, issue progressively higher fines for all subsequent minor violations of rules within the next 24-month period or initiate more formal disciplinary proceedings.<sup>6</sup>

### Failure to Timely Submit Amendments to Forms U5

In July 2002, an NASD task force (the Public Information Review or PIR Task Force) initiated a comprehensive review of disciplinary and other information that NASD makes public. In *Notice to Members 04-23* (March 2004), NASD requested comment from its members and other interested parties on two of the PIR Task Force's recommendations. One of these recommendations was to expand the coverage of NASD's MRVP to include the failure to amend the Form U5 in a timely manner. The recommendation was part of a multi-pronged effort to help ensure that members make required disclosures on all uniform registration forms in a timely manner.<sup>7</sup>

Including the failure to timely submit amendments to the Form U5 in NASD's MRVP gives NASD the additional flexibility to resolve these violations as it has regarding the failure to timely submit amendments to the Form U4 (Uniform Application for Securities Industry Registration or Transfer) and Form BD (Uniform Application for Broker-Dealer Registration),<sup>8</sup> and it gives NASD staff the ability to impose a meaningful sanction for violations that warrant more than a Letter of Caution but do not necessarily rise to a level meriting a full disciplinary proceeding. As with all violations included in NASD's MRVP, NASD staff will continue to determine on a case-by-case basis whether a particular violation merits disposition under its MRVP or warrants formal disciplinary action.

---

## Endnotes

- 1 See Exchange Act Rel. No. 50446 (Sept. 24, 2004), 69 F.R. 58568 (Sept. 30, 2004) (SR-NASD-2004-121).
- 2 See Exchange Act Rel. No.21013 (June 1, 1984), 49 F.R. 23828 (June 8, 1984).
- 3 See Exchange Act Rel. No. 32076 (Mar. 31, 1993), 58 F.R. 18291 (Apr. 8, 1993); see also *Notice to Members 93-42* (July 1993).
- 4 See Exchange Act Rel. No. 44512 (July 3, 2001), 68 F.R. 36812 (July 13, 2001).
- 5 See Exchange Act Rel. No. 50446 (Sept. 24, 2004), 69 F.R. 58568 (Sept. 30, 2004) (SR-NASD-2004-121). NASD also has proposed to add six additional rule violations to its MRVP. See SR-NASD-2004-025. Specifically, that proposal, which remains pending at the SEC, would add: (1) violation of the Intermarket Trading System (ITS) trade-through rule; (2) violation of the locked and crossed markets rule; (3) violation of the Trade Reporting and Compliance Engine (TRACE) system transaction reporting requirement; (4) violation of the Alternate Display Facility (ADF) transaction reporting requirement; (5) violation of the standards applicable to communications with the public; and (6) failure to provide or update firm contact information as required by NASD rules.
- 6 See *Notice to Members 04-19* (March 2004) (NASD Releases Minor Rule Violation Plan (MRVP) Guidelines), which provides interested parties with guidance concerning the application of NASD's MRVP to each of the rules under the Plan, as specified in NASD IM-9216. This guidance includes identifying the factors to be considered in determining whether to dispose of an action under the MRVP and discussing the appropriate levels for fines. NASD will update this guidance to reflect the addition to its MRVP of the failure to timely submit amendments to Forms U5.
- 7 This effort includes the newly established late disclosure fee, which was another recommendation of the PIR Task Force. See Exchange Act Rel. No. 49224 (Feb. 11, 2004), 69 F.R. 7833 (Feb. 19, 2004) (File No. SR-NASD-2003-192). See also *Notice to Members 04-09* (March 2004).
- 8 More specifically, NASD's MRVP also includes: (1) failure to timely submit amendments to Form U4 (as required by Article V, Section 2(c) of the NASD By-Laws); and (2) failure to timely submit amendments to Form BD (as required by Article IV, Section 1(c) of the NASD By-Laws).

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

---

## ATTACHMENT A

Below is the text of the proposed rule change. Additions are underlined; deletions are in brackets.

\* \* \* \* \*

### 9200. DISCIPLINARY PROCEEDINGS

\* \* \* \* \*

#### IM-9216. Violations Appropriate for Disposition Under Plan Pursuant to SEC Rule 19d-1(c)(2)

—Rule 2210(b) and (c) and Rule 2220(b) and (c)—Failure to have advertisements and sales literature approved by a principal prior to use; failure to maintain separate files of advertisements and sales literature containing required information; and failure to file communications with the Association within the required time limits.

—Rule 3360—Failure to timely file reports of short positions on Form NS-1.

—Rule 3110—Failure to keep and preserve books, accounts, records, memoranda, and correspondence in conformance with all applicable laws, rules, regulations and statements of policy promulgated thereunder, and with the Rules of the Association.

—Rule 8211, Rule 8212, and Rule 8213—Failure to submit trading data as requested.

—Article IV of the NASD By-Laws—Failure to timely submit amendments to Form BD.

—Article V of the NASD By-Laws —Failure to timely submit amendments to Form [U-4] U4.

—Article V of the NASD By-Laws —Failure to timely submit amendments to Form U5.

—Rule 1120—Failure to comply with the Firm Element of the continuing education requirements.

—Rule 3010(b)—Failure to timely file reports pursuant to the Taping Rule.

—Rule 3070—Failure to timely file reports.

—Rule 4619(d)—Failure to timely file notifications pursuant to SEC Regulation M.

—Rules 4632, 4642, 4652, 6240, 6420, 6550, 6620, and 6720—Transaction reporting in equity, convertible debt, and high yield securities.

—Rules 6130 and 6170—Transaction reporting to the Automated Confirmation Transaction Service (“ACT”).

---

—Rules 6954 and 6955—Failure to submit data in accordance with the Order Audit Trail System (“OATS”).

—Rule 11870—Failure to abide by Customer Account Transfer Contracts.

—SEC Exchange Act Rule 11Ac1-4—Failure to properly display limit orders.

—SEC Exchange Act Rule 11Ac1-1(c)(5)—Failure to properly update published quotations in certain Electronic Communication Networks (“ECN’s”).

—SEC Exchange Act Rule 17a-5—Failure to timely file FOCUS reports and annual audit reports.

—SEC Exchange Act Rule 17a-10—Failure to timely file Schedule I.

—MSRB Rule A-14—Failure to timely pay annual fee.

—MSRB Rule G-12—Failure to abide by uniform practice rules.

—MSRB Rule G-14—Failure to submit reports.

—MSRB Rule G-36—Failure to timely submit reports.

—MSRB Rule G-37—Failure to timely submit reports for political contributions.

—MSRB Rule G-38—Failure to timely submit reports detailing consultant activities.

\* \* \* \* \*

# Notice to Members

OCTOBER 2004

## SUGGESTED ROUTING

Continuing Education  
Legal and Compliance  
Registered Representatives  
Registration  
Senior Management  
Training

## KEY TOPICS

Continuing Education  
Regulatory Element  
Rule 1120

## GUIDANCE

### Regulatory Element Exemptions

SEC Approves Amendments to Rule 1120 to Eliminate Exemptions from the Continuing Education Regulatory Element Requirements; **Effective Date: Anticipated April 2005; Specific Date to be Announced in Future**  
*Notice to Members*

#### Executive Summary

On September 27, 2004, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 1120 (Continuing Education Requirements) to eliminate all current exemptions from the continuing education Regulatory Element requirements. The text of the amendments is set forth in Attachment A. The amendments will become effective on the later of: (1) April 4, 2005; or (2) 30 days following the implementation of the necessary related changes to Web CRD®. NASD will announce the specific effective date, which shall be on or after April 4, 2005, in a future *Notice to Members*.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to Ann M. Griffith, Associate Vice President and Director, NASD Testing and Continuing Education Department, at (240) 386-5051; Joe McDonald, Associate Director, NASD Testing and Continuing Education Department, at (240) 386-5065; or Patricia Albrecht, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8026.

---

## Background

NASD Rule 1120 specifies the continuing education (CE) requirements for registered persons subsequent to their initial qualification and registration with NASD. The requirements consist of a Regulatory Element component outlined in Rule 1120(a) and a Firm Element component outlined in Rule 1120(b).<sup>1</sup> The Regulatory Element is a computer-based education program administered by NASD to help ensure that registered persons are kept up-to-date on regulatory, compliance, and sales practice matters in the industry.<sup>2</sup> Unless exempt, each registered person is required to complete the Regulatory Element initially within 120 days after the person's second registration anniversary date and, thereafter, within 120 days after every third registration anniversary date.<sup>3</sup> There are three Regulatory Element programs: the S201 Supervisor Program for registered principals and supervisors, the S106 Series 6 Program for Series 6 representatives, and the S101 General Program for Series 7 and all other registrations. Registered persons who fail to complete the Regulatory Element are deemed inactive, must cease all activities as a registered person, and are prohibited from performing any duties and functioning in any capacity requiring registration.<sup>4</sup>

Approximately 135,000 registered persons currently are exempt from the Regulatory Element. These include registered persons who, when the CE Program was adopted in 1995, had been registered for at least ten years and who did not have a significant disciplinary action<sup>5</sup> in their CRD record for the previous ten years ("grandfathered" persons). Also included are those persons who "graduated" from the Regulatory Element by satisfying their tenth anniversary requirement before July 1998, when Rule 1120 was amended and the graduation provision eliminated, and who did not have a significant disciplinary action in their CRD record for the previous ten years.<sup>6</sup>

At its December 2003 meeting, the Securities Industry/Regulatory Council on Continuing Education (Council)<sup>7</sup> discussed the current exemptions from the Regulatory Element and agreed unanimously to recommend that the SROs repeal the exemptions and require all registered persons to participate in the Regulatory Element. In reaching this conclusion, the Council was of the view that there is great value in exposing all industry participants to the benefits of the Regulatory Element, in part because of the significant regulatory issues that have emerged over the past few years. The Regulatory Element programs include teaching and training content that is continuously updated to address current regulatory concerns as well as new products and trading strategies. Exempt persons currently do not have the benefit of this material.<sup>8</sup>

---

## Discussion

Based on the Council's recommendation, NASD proposed changes to Rule 1120 in June 2004 to eliminate all currently effective exemptions from the requirement that registered persons complete the Regulatory Element of the CE Program.<sup>9</sup> The SEC approved those rule changes on September 27, 2004.<sup>10</sup> The amendments become effective on the later of: (1) April 4, 2005; or (2) 30 days following the implementation of the necessary related changes to Web CRD. NASD will announce the specific effective date, which shall be on or after April 4, 2004, in a future *Notice to Members*.

The reentry into the Regulatory Element program of all formerly exempt registered persons will occur over a three-year period using each registered person's "base date." Usually, the base date is the person's initial securities registration. However, the base date may be revised to be the effective date of a significant disciplinary action in accordance with Rule 1120(a)(3) or the date on which a formerly registered person re-qualifies for association with an NASD member by qualification exam. Using the base date, CRD will then create a Regulatory Element requirement on the second anniversary of the base date and then every three years thereafter. Every registered person formerly exempt from the Regulatory Element requirement must satisfy such requirement on the occurrence of a Regulatory Element base date anniversary (*i.e.*, the second anniversary of the base date and every three years thereafter) (see examples in the table below).

NASD staff has reviewed a projection of how the anniversaries of the approximately 135,000 formerly exempt registered persons will occur using the base dates that CRD maintains for these persons. The projection shows that within three years from the proposed rule's effective date, all formerly exempt registered persons will have been brought into the Regulatory Element program. Furthermore, anniversaries will occur at a more-or-less steady rate so that there would be no extraordinary stress placed upon the capacity of the existing test/training facilities during the next three years or thereafter.

**Table**

Registered Person	Initial Registration Date	First Regulatory Element Requirement of a Registered Person Formerly Exempt from the Regulatory Element (assuming an effective date of April 4, 2005)
A	4/4/1985 <sup>11</sup>	4/4/2005
B	7/1/1983	7/1/2006
C	8/1/1984	8/1/2007
D	4/3/1985	4/3/2008

---

NASD plans on informing each firm of its currently exempted registered persons who will be reentered into the Regulatory Element program. In November 2004, NASD will send an e-mail (and a follow-up hard copy letter) to each firm's Regulatory Element contact person listing each currently exempted registered person and the date on which such person will be required to complete his or her Regulatory Element requirement. NASD will send reminder e-mails to each Regulatory Element contact person in January 2005 and again in March 2005.

The Regulatory Element programs are administered at conveniently located test centers operated by Pearson and Prometric professional testing center networks. Appointments to take the Regulatory Element sessions can be scheduled through either network:

Pearson Professional Centers: contact Pearson VUE's National Registration Center at **1-866-396-6273 (toll free)**, or **1-952-681-3873 (toll number)** or go to [www.pearsonvue.com/nasd](http://www.pearsonvue.com/nasd) for Web-based scheduling.

Prometric Testing Centers: contact Prometric's National Call Center at **1-800-578-6273 (toll free)** or go to [www.prometric.com/nasd](http://www.prometric.com/nasd) for Web-based scheduling.

For more information about the Council's Continuing Education Program, see the Council's website at [www.securitiescep.com](http://www.securitiescep.com).

## Endnotes

- 1 The Firm Element of the CE Program applies to any person registered with an NASD member firm who has direct contact with customers in the conduct of the member's securities sales, trading, and investment banking activities; any person registered as a research analyst pursuant to Rule 1050; and to the immediate supervisors of such persons (collectively called "covered registered persons"). The requirement stipulates that each member firm must maintain a continuing and current education program for its covered registered persons to enhance their securities knowledge, skill, and professionalism. Each firm has the requirement to annually conduct a training needs analysis, develop a written training plan, and implement the plan.
- 2 Rule 1120(a)(6) permits a member firm to deliver the Regulatory Element to registered persons on firm premises (In-Firm Delivery) as an option to having persons take the training at a designated center provided that firms comply with specific requirements relating to supervision, delivery sites, technology, administration, and proctoring. In addition, Rule 1043 requires that persons serving as Proctors for the purposes of In-Firm Delivery must be registered.
- 3 See Rule 1120(a)(1). This is the current Regulatory Element schedule, as amended in 1998.
- 4 Rule 1120(a)(2).

- 
- 5 For purposes of Rule 1120, a significant disciplinary action generally means a statutory disqualification, a suspension, or imposition of a fine of \$5,000 or more, or being subject to an order from a securities regulator to re-enter the Regulatory Element. See Rule 1120(a)(3).
  - 6 When Rule 1120 was first adopted in 1995, the Regulatory Element schedule required registered persons to satisfy the Regulatory Element on the second, fifth, and tenth anniversaries of their initial securities registration. After satisfying the tenth anniversary requirement, a person was “graduated” from the Regulatory Element. A graduated principal re-entered the Regulatory Element if he or she incurred a significant disciplinary action. A graduated person who was not a principal re-entered if he or she acquired a principal registration or incurred a significant disciplinary action.
  - 7 As of the date of this *Notice*, the Council consists of 20 individuals, six representing self-regulatory organizations (SROs) (the American Stock Exchange LLC, the Chicago Board Options Exchange, Inc., the Municipal Securities Rulemaking Board, NASD, the New York Stock Exchange, Inc. (NYSE), and the Philadelphia Stock Exchange, Inc.) and 14 representing the industry. The Council was organized in 1995 to facilitate cooperative industry/regulatory coordination of the CE Program in keeping with applicable industry regulations and changing industry needs. Its roles include recommending and helping to develop specific content and questions for the Regulatory Element, defining minimum core curricula for the Firm Element, developing and updating information about the program for industry-wide dissemination, and maintaining the program on a revenue-neutral basis while assuring adequate financial reserves.
  - 8 In addition, the Council plans to introduce a new content module to the Regulatory Element programs in 2005 that will specifically address ethics and will require participants to recognize ethical issues in given situations. Participants will be required to make decisions in the context of, for example, peer pressure, the temptation to rationalize, or a lack of clear-cut guidance from existing rules or regulations. The Council strongly believes that all registered persons, regardless of their years of experience in the industry, should have the benefit of this training.
  - 9 See SR-NASD-2004-98. The proposed rule changes also replaced references in Rule 1120(a)(3) to “re-entry” into the Regulatory Element with a requirement to “retake” the Regulatory Element to clarify that the significant disciplinary action provisions apply to all registered persons and not only to currently exempt persons.
  - 10 Exchange Act Release No. 50456 (September 27, 2004); 69 F.R. 59285 (October 4, 2004). The SEC also approved amendments to NYSE Rule 345A to eliminate all currently effective exemptions from the requirement that registered persons complete the Regulatory Element of the CE program. See Exchange Act Release No. 50404 (September 16, 2004), 69 F.R. 57126 (September 23, 2004).
  - 11 A registered person with an initial registration date of April 4, 1985 will have a Regulatory Element anniversary date on April 4 of 1987, 1990, 1993, 1996, 1999, 2002, and 2005.

---

©2004. NASD. All rights reserved. *Notices to Members* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

---

## ATTACHMENT A

New language is underlined; deletions are in brackets.

\* \* \* \* \*

### 1120. Continuing Education Requirements

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

#### (a) Regulatory Element

##### (1) Requirements

No member shall permit any registered person to continue to, and no registered person shall continue to, perform duties as a registered person unless such person has complied with the requirements of paragraph (a) hereof.

[A] Each registered person shall complete the Regulatory Element on the occurrence of their second registration anniversary date and every three years thereafter, or as otherwise prescribed by NASD [the Association]. On each occasion, the Regulatory Element must be completed within 120 days after the person's registration anniversary date. A person's initial registration date, also known as the "base date," shall establish the cycle of anniversary dates for purposes of this Rule. The content of the Regulatory Element shall be determined by NASD [the Association] and shall be appropriate to either the registered representative or principal status of person subject to the Rule.

[B] Persons Exempted from the Rule — Persons who have been continuously registered for more than 10 years on July 1, 1998, shall be exempt from participation in the Regulatory Element programs for registered representatives, provided such persons have not been subject within the last 10 years to any disciplinary action as enumerated in paragraph (a)(3). A person who has been continuously registered as a principal for more than ten years on July 1, 1998, shall be exempt from participation in the Regulatory Element programs for registered principals, provided such person has not been subject within the last ten years to any disciplinary action as enumerated in paragraph (a)(3). In the event that a registered representative or principal who was exempt from participation in Regulatory Element programs subsequently becomes the subject of a disciplinary action as enumerated in paragraph (a)(3), such person shall be required to satisfy the requirements of the Regulatory Element as if the date of such disciplinary action is such person's initial registration date with the Association.]

---

[(C) Persons who have been currently registered for 10 years or less as of July 1, 1998, shall participate in the Regulatory Element within 120 days after the occurrence of the second registration anniversary date, or every third year thereafter, whichever anniversary date first applies.]

(2) No change.

**(3) Disciplinary Actions [Re-entry into Program]**

Unless otherwise determined by NASD [the Association], a registered person will be required to retake [re-enter] the Regulatory Element and satisfy all of its requirements in the event such person:

(A) is subject to any statutory disqualification as defined in Section 3(a)(39) of the Act;

(B) is subject to suspension or to the imposition of a fine of \$5,000 or more for violation of any provision of any securities law or regulation, or any agreement with or rule or standard of conduct of any securities governmental agency, securities self-regulatory organization, or as imposed by any such regulatory or self-regulatory organization in connection with a disciplinary proceeding; or

(C) is ordered as a sanction in a disciplinary action to retake [re-enter] the Regulatory Element [continuing education program] by any securities governmental agency or self-regulatory organization.

The retaking of the Regulatory Element [Re-entry] shall commence with [initial] participation within 120 days of the registered person becoming subject to the statutory disqualification, in the case of (A) above, or the disciplinary action becoming final, in the case of (B) and (C) above. The date of the disciplinary action shall be treated as such person's new base [initial registration] date with NASD [the Association].

(4) through (7) No change.

No change.

\* \* \* \* \*

# Disciplinary and Other NASD Actions

## REPORTED FOR OCTOBER

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 September 2004.

### Firms Fined, Individuals Sanctioned

EDI Financial, Inc. (CRD #15699, Dallas, Texas) and Martin William Prinz (CRD #1330601, Registered Principal, Southlake, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which they were fined \$25,000, jointly and severally. Additionally, the firm was censured and Prinz was suspended from association with any NASD member in any principal capacity for 30 business days. Without admitting or denying the allegations, the firm and Prinz consented to the described sanctions and to the entry of findings that the firm, acting through Prinz, engaged in a securities business when the firm's net capital was below the minimum requirement and failed to accurately file FOCUS Part IIA reports. The findings also stated that the firm, acting through Prinz, failed to keep current its general ledger and trial balance, failed to have a financial and operations principal (FINOP), and maintained the NASD registration of the firm's former FINOP who was not involved in the financial and operational management of the firm. In addition, NASD found that the firm, acting through Prinz, failed to establish and maintain a system to supervise the activities of an owner of the firm who was performing duties requiring registration as a FINOP but was not registered as a FINOP; and failed to establish and maintain a system to supervise, including the establishment and maintenance of written procedures, the accuracy and maintenance of the firm's financial books and records so as to ensure the firm complied with all aspects of the net capital rule.

Prinz' suspension began October 18, 2004, and will conclude at the close of business November 29, 2004. (NASD Case #C06040026)

Kirlin Securities, Incorporated (CRD #21210, Syosset, New York), Anthony Joseph Kirincic (CRD #1499511, Registered Principal, Dix Hills, New York), AiLin Khoo Dorsey (CRD #2198636, Registered Principal, South San Francisco, California), Paul Thomas Garvey (CRD #1214388, Registered Representative, Orinda, California), and Brian Francis McEnery (CRD #2735200, Registered Representative, San Francisco, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured; fined \$155,800; ordered to pay \$1,044,732.35 in restitution to public customers, \$26,185.39 jointly and severally with Garvey, and \$48,107.99 jointly and severally with McEnery; ordered to file all sales literature and advertising with NASD's Advertising Regulation Department at least 10 days prior to their first use for one year from the date of acceptance by the National Adjudicatory Council (NAC) of the Letter of Acceptance, Waiver, and Consent (AWC); and ordered to retain an independent consultant

to review and make recommendations concerning the adequacy of the firm's supervisory and operating procedures as they relate to review of advertising and sales literature, books and recordkeeping, corporate debt, municipal securities, and equity transactions, including markups, markdowns, and commissions charged. Kirincic was fined \$25,000 and suspended from association with any NASD member as a Series 24 (General Securities Principal) for 30 days. Dorsey was fined \$15,000 and suspended from association with any NASD member in a principal or supervisory capacity for 20 business days. Garvey was fined \$10,000 and suspended from association with any NASD member in any capacity for 14 days. McEnery was censured and fined \$10,000.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through its employees, participated, directly or indirectly, in undertakings involving the sale of and interest in Brady Bonds with a view to the distribution of such securities and acted as underwriters of the securities in violation of Section 5 of the Securities Act of 1933. The findings also stated that the firm, acting through its employees, developed and disseminated to the public advertising materials that failed to disclose material facts regarding the Brady Bonds and included exaggerated, unwarranted, or misleading statements or claims about the Brady Bonds. NASD also found that the firm, acting through its employees, failed to determine markups on the basis of the firm's contemporaneous costs, thereby charging its retail customers fraudulently excessive markups. In addition, NASD found that the firm, acting through Kirincic, failed to establish and maintain an adequate supervisory system in connection with the advertising, sale, and distribution of Brady Bonds. NASD found that written procedures failed to identify how the firm's principals were to review transactions for excessive pricing and markups, when such a review should take place, and how to determine markups if the firm was dominating and controlling the trading of a security. Furthermore, NASD found that the firm, acting through Kirincic, failed to maintain either hard or electronic copies of Brady Bond inventory sheets and discarded the sheets on a daily basis.

NASD found that the firm, through its employees, obtained undisclosed profits in transactions with public customers by taking positions to match customer orders and then executing the customer orders as principal transactions later in the same day, taking the intra-day profits from the transactions for itself. In addition, NASD found that the firm and its employees failed to give public customers best execution on trades when it took "trading profits" and when it executed principal transactions at prices less favorable than the prevailing inter-dealer price at the time of the trade. NASD also found that the firm failed to maintain books and records; failed to maintain trading tickets of customer's transactions; failed to maintain accurate records of the time of receipt of the customer's orders

and the instructions the customer gave in making the orders; failed to make and keep memoranda of each order; failed to mark limit orders and market orders with restrictions and the conditions of each order and trading tickets; failed to accurately record the terms and conditions on the customer's limit orders; and failed to keep identifiable contemporaneous records showing whether an order was a market order or a limit order. Furthermore, NASD found that the firm that firm's records failed to reflect unsolicited orders; that time stamps on orders failed to reflect the time the customer placed the order; that the firm reported transactions before it time-stamped order tickets and executed the transactions before it time-stamped the orders as received; that the firm sent confirmations to public customers that failed to disclose profits the firm received; that the firm treated trades with customers in which it did not take secret profits as riskless principal transactions but provided the customers with confirmations describing them inaccurately as principal transactions; and that, in agency cross trades, the firm sent customers confirmations that failed to disclose the amount of all commission or remuneration and either the name of the person from whom the security was purchased, to whom it was sold, or the fact that such information would be furnished upon request.

NASD also found that the firm reported or confirmed the trades as principal transactions and did not submit either a clearing-only report or a non-tape, non-clearing report in principal trades with public customers in which the firm did not take undisclosed profits; reported trades as principal transactions even though the trades were riskless cross trades; failed to submit or confirm trades with customers to ACT; and reported one transaction more than 90 seconds after execution. In addition, NASD found that the firm failed to establish and maintain supervisory procedures reasonably designed to achieve compliance with federal securities laws and NASD rules relating to interpositioning, front-running, best execution, books and records, and trade reporting requirements. The findings also stated that the firm failed to designate principals with supervisory responsibility for interpositioning and for implementing procedures when front-running was detected. NASD found that Dorsey failed in her supervisory duties in her review of documents and knew or should have known that the majority of customer trades involved large undisclosed concessions taken by the firm in addition to commissions, markups, or markdowns, and failed to make reasonable inquiry into the transactions or conduct adequate follow-up.

Furthermore, NASD found that the firm, Garvey, and McEnery charged excessive amounts on principal transactions and failed to take into account factors identified in NASD Rule IM-2440 that should be considered in determining the fairness of charges. Dorsey, as a registered principal, reviewed and approved the amount charged on each of the transactions. Moreover, the firm failed to establish and maintain a supervisory

system reasonably designed to achieve compliance with NASD rules relating to charges to customers and failed to reflect how the factors enumerated in NASD Rule IM-2440 should be taken into account. Dorsey, as the registered principal responsible for reviewing and approving the amount charged on transactions failed to take appropriate action to ensure that the firm's charges to customers were reasonable.

Moreover, NASD found that the firm failed to conduct an annual review of an Office of Supervisory Jurisdiction and failed to report, and to report timely, statistical and summary information regarding written customer complaints pursuant to NASD Rule 3070. In addition, NASD found that the firm, acting through its employees, failed to enforce the firm's procedures relating to its review of corporate debt, municipal transactions, and equity securities transactions. The findings also stated that Kirincic failed to enforce or delegate the responsibility of enforcing the firm's procedures relating to review of equity securities transactions. NASD also found that the firm failed to properly notate whether a sale was "long" or "short" on order memoranda for sell transactions; failed to report properly certain equity security transactions in a timely manner with all correct modifiers; failed to report correctly the price at which transactions were executed; and failed to report transactions reviewed to the Fixed Income Pricing (FIPS) reporting system.

Kirincic's suspension began September 20, 2004, and will conclude at the close of business October 19, 2004. Dorsey's suspension began September 20, 2004, and concluded at the close of business October 15, 2004. Garvey's suspension began September 20, 2004, and concluded October 3, 2004. (NASD Case #CAF040063)

## Firms and Individuals Fined

**American National Municipal Corporation (CRD #44860, Woodland Hills, California) and John Thomas Ford (CRD #2206110, Registered Principal, Fillmore, California)** 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 firm and Ford consented to the described sanctions and to the entry of findings that the firm, acting through Ford, failed to report timely statistical and summary information concerning customer complaints to NASD pursuant to NASD Rule 3070c. (NASD Case #C02040034)

**Austin Securities, Inc. (CRD #17094, Forest Hills, New York) and Brian Robert Mitchell (CRD #1191608, Registered Principal, Yorktown Heights, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$14,000, jointly and severally. Without admitting or denying the allegations, the firm and Mitchell consented to the described sanctions and to the entry of findings that the firm,

acting through Mitchell, permitted an individual to act in a capacity that required registration while the individual's registration status with NASD was inactive due to his failure to complete the Regulatory Element of NASD's Continuing Education Requirement. The findings also stated that the firm, acting through Mitchell, allowed another individual to maintain his registration as a general securities representative through his purported association with the firm when, in fact, he was not actively involved in the firm's securities business or otherwise functioning as a representative of the firm. (NASD Case #C10040094)

**Bossio Financial Group, Inc. (CRD #43970, Wixom, Michigan) and Alan John Bossio (CRD #2502983, Registered Principal, Farmington Hills, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$13,000, jointly and severally, and the firm was fined an additional \$2,500. Without admitting or denying the allegations, the firm and Bossio consented to the described sanctions and to the entry of findings that the firm commenced an offering of 2,000,000 shares of series C convertible preferred stock (Share) through the use of a private placement memorandum. The memorandum represented that the offering was contingent upon the subscription of a minimum number of Shares. The findings also stated that the memorandum further represented that if the condition was not satisfied, none of the Shares would be sold, the investor's funds would be returned without any reduction, and that all subscription funds would be held in a "segregated, interest bearing escrow account" by the firm and "will not be released to the company (or any selling commissions or finder's fees paid) until at least \$500,000 of the Shares are sold." The document further stated that "unless at least \$500,000 of Shares are sold by the Offering Termination Date, all of the investors' funds and interest earned thereon while they were deposited into that escrow account will be returned to them" by the firm. NASD found that the firm sold Shares of the security to members of the public and the customer's funds were deposited into a bank account in the name of the company and the signators on the segregated account were Bossio and another individual.

In addition, NASD determined that the firm, acting through Bossio, permitted the release of \$130,000 before the firm collected \$500,000 from investors. The findings also included that, in connection with the sale of the shares, the firm, acting through Bossio, rendered false and misleading representations in the memorandum and subscription agreement that the purchaser's funds would be held in a segregated, interest-bearing escrow account and would not be released to a company (or any selling commissions or finder's fees paid) until at least \$500,000 of Shares were sold, in that the firm, acting through Bossio, failed to properly escrow purchasers' funds in a segregated account from June 28, 2002 to July 11, 2002, and improperly forwarded the funds to the company prior to the

collection of the required minimum purchases. The findings also stated that the firm used the mails or other means or instrumentalities of interstate commerce to effect transactions in securities, or received and held customer funds or securities, while the firm failed to maintain the minimum required net capital.

Moreover, NASD found that the firm filed with NASD a FOCUS Part IIA Report that was inaccurate in that, among other things, the report overstated the firm's net capital. NASD found that the firm received funds from public customers for the purchase of shares of securities and held the funds in a bank account that was, in part, controlled by Bossio; while pursuant to the membership agreement, the firm agreed that it would not hold customer funds and operate pursuant to the exemptive provisions of SEC Rule 15c3-3(k)(2)(i). The findings stated that the firm, acting through Bossio, received and held customer funds in a bank account while failing to open and use a special reserve bank account for the exclusive benefit of customers that meets the requirements of SEC Rule 15c3-3(f), and failed to compute the member's special reserve requirement pursuant to SEC Rule 15c3-3. (NASD Case C8A040074)

**Brookstreet Securities Corporation (CRD #14667, Irvine, California) and Stanley Clifton Brooks (CRD #31684, Registered Principal, San Clemente, California)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$10,000, jointly and severally. The firm was also required to demonstrate to NASD within 90 days of acceptance of the AWC that it had established procedures for the review and investigation by a designated principal of all information reflected on the Uniform Application for Securities Industry Registration or Transfer (Form U4) submitted by each applicant to the firm for association as a registered or associated person. Without admitting or denying the allegations, the firm and Brooks consented to the described sanctions and to the entry of findings that the firm, acting through Brooks, had sufficient information to raise concerns about whether a registered representative's activities were in compliance with NASD rules pertaining to private securities transactions, but Brooks failed to supervise the representative in a manner reasonably calculated to prevent violation of NASD rules. (NASD Case #C02040031)

**Cardinal Capital Management, Inc., (CRD #24605, Miami, Florida) and Christopher Alan Sweeney (CRD #823375, Registered Principal, Palm City, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$18,500, jointly and severally, of which \$12,500, is jointly and severally with Sweeney. Sweeney was also censured. Without admitting or denying the allegations, the firm and Sweeney consented to the described sanctions and to the entry of findings that the firm failed to maintain correspondence of its registered representatives relating to its investment banking or securities business. NASD also found that the firm, acting

through Sweeney, failed to prepare a written needs analysis and training plan for the calendar year 2000 and further permitted at least two representatives to act in registered capacities while their registrations were inactive due to their failures to satisfy the Regulatory Element of their Continuing Education Requirements. The findings also stated that the firm conducted a securities business while it failed to maintain its required net capital, inaccurately calculated its net capital, maintained inaccurate books and records, and filed inaccurate FOCUS reports. In addition, NASD determined that the firm, acting through Sweeney, filed five quarterly reports in an untimely manner. (NASD Case #C07040073)

**FEA, Inc. (CRD #24376, Northbrook, Illinois) and John Herman Cox (CRD #1944308, Registered Principal, Glenview, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm and Cox were censured and fined \$12,500, jointly and severally, and the firm was fined an additional \$2,500. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm used the mails or other means or instrumentalities of interstate commerce to effect transactions in securities, or received and held customer funds or securities while the firm failed to maintain the minimum required net capital. The findings also stated that the firm failed to comply with the terms of its membership agreement when it received funds from public customers for the purchase of interests in securities and held the funds in a bank account controlled by Cox while pursuant to the Membership Agreement, the firm and Cox agreed that it would not hold customer funds and operate pursuant to the exemptive provisions of SEC Rule 15c3-3(k)(2)(i).

NASD also found that the firm, acting through Cox, received and held public customer funds in bank accounts while failing to open and use a special reserve bank account for the exclusive benefit of customers and failed to compute the firm's special reserve requirement pursuant to SEC Rule 15c3-3 as of month-end and withdrawal dates. In addition, NASD determined that the firm commenced an offering of limited partnership interests through the use of private placement memorandum at a price of \$50,000 per unit. The memorandum represented that the offering was contingent upon the number of subscription units by the termination of the offering with the right to extend the offering for an additional 30 days or "all subscriptions received will be promptly refunded to subscribers without interest, charge or deduction". The memorandum further represented that payments received from subscribers would be held in a demand deposit escrow account and would not be commingled with any other funds. NASD found that the firm, acting through Cox, failed to promptly return the subscribers' funds or obtain written reconfirmations of the offerings from the existing subscribers by the due date; such failure rendered the representation in the Memorandum and Subscription Agreement false and misleading. The findings also stated that the firm

commenced an offering of securities, through the use of Private Placement Memorandum at a price of \$50,000 per unit. The memorandum represented that the offering was contingent upon the number of subscription units by the termination of the offering with the right to extend the offering for an additional 30 days, or "all subscriptions received will be promptly refunded to subscribers without interest, charge or deduction." The memorandum further represented that payments received from subscribers would be held in a demand deposit escrow account pending termination of the offering and would not be commingled with any other funds. Moreover, the findings stated that the memorandum represented that the "General Partner and its affiliates reserve the right to purchase units at any time during the offering, and be treated as a Class A Limited Partner. Such purchase may not be for investment, but may be with a view towards resale or distribution of the units so acquired in accordance with applicable law." NASD found that Cox purchased seven units for \$350,000 to achieve the required minimum amount necessary to release the funds and forward the securities. While the memorandum disclosed the fact that Cox could purchase units of securities, it failed to disclose the total amount of units that the general partner and its affiliates could purchase and that the purchases would be for investment, not resale, rendering the Memorandum as false and misleading. (NASD Case #C8A040075)

**Shields and Company (CRD #11053, New York, New York) and John Patrick Hughes, Jr. (CRD #2486574, Registered Representative, Hasbrouck, New Jersey)** submitted an Offer of Settlement in which they were censured and fined \$20,000, jointly and severally. Without admitting or denying the allegations, the firm and Hughes consented to the described sanctions and to the entry of findings that the firm, acting through Hughes, failed to establish and maintain a reasonably designed supervisory system. (NASD Case #C07040064)

**Centaurus Financial, Inc. (CRD #30833, Orange, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000, \$5,000 of which was jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to file timely a report regarding events required to be disclosed pursuant to NASD Rule 3070(b) and a report concerning statistical and summary information relating to customer complaints pursuant to NASD Rule 3070(c). (NASD Case #C02040029)

**Deutsche Bank Securities, Inc. (CRD #2525, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it incorrectly reported to the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) "at-risk" principal transactions in NASDAQ National Market<sup>®</sup> (NNM<sup>®</sup>) securities as non-media with a "riskless principal" capacity. The findings also stated that the firm failed

to submit, for the offsetting, a "riskless" portion of "riskless" principal transactions in NNM securities, either a clearing-only report with a capacity indicator of "riskless principal," or a non-tape, non-clearing report with a capacity indicator of "riskless principal." The findings further stated that the firm failed to report to ACT the correct price for a "riskless principal" transaction. In addition, NASD found that the firm failed to provide written notification disclosing to its customer that the transactions were executed at an average price and incorrectly documented the average price disclosure on three occasions. (NASD Case #CMS040137)

**Donaldson, Lufkin & Jenrette Securities Corp. (CRD #816, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$100,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to establish and maintain a supervisory system and written supervisory procedures designed to ensure that a registered representative complied with all applicable securities laws, regulations, and NASD rules in his role as the portfolio manager of a limited partnership. The findings also stated that although several of the firm's principals knew that the representative was managing partnership assets and was soliciting brokerage clients to become investors in the partnership, the firm failed to designate a principal and failed to develop written supervisory procedures for the partnership to supervise the representative's activities. NASD also found that the firm failed to ensure that procedures were in place to review the distribution of quarterly performance reports and written commentary prepared by the representative for the limited partners. (NASD Case #CAF040066)

**First New York Securities, L.L.C. (CRD #16362, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to file Large Option Position Reports (LOPRs) with NASD to report positions of conventional option contracts. (NASD Case #CMS040127)

**Garden State Securities, Inc. (CRD #10083, Wall, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it did not report trades within the required 90 seconds and did not report the trades as late trades utilizing the .SLD modifier. The findings also stated that the firm failed to ensure that the business clocks it utilized for trade reporting purposes were synchronized in conformity with NASD rules. NASD also found that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to ensure compliance with ACT reporting rules. (NASD Case #C9B040082)

**Murphy & Durieu (CRD #6292, 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, regulations, and NASD rules concerning ACT trade reporting within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last sale reports of transactions in OTC equity securities and failed to designate through ACT such last sale reports as late. The findings further stated that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning ACT trade reporting. **(NASD Case #CMS040130)**

**National Clearing Corp. (CRD #14343, Beverly Hills, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it failed to file settlement and award disclosures; failed to file a disclosure regarding an internal disciplinary action; and failed to file a settlement disclosure in a timely manner pursuant to NASD Rule 3070(b). The findings also stated that the firm failed to file, and to file timely, quarterly reports concerning statistical and summary information relating to customer complaints pursuant to NASD Rule 3070(c). NASD also found that the firm failed to report accurately to the Municipal Securities Rulemaking Board (MSRB) the correct time of execution regarding reported transactions and failed to report customer transactions to the MSRB. **(NASD Case #C02040027)**

**Prudential Equity Group, LLC (CRD #7471, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$30,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short sale transactions and failed to report each of these transactions to ACT with a short sale modifier. NASD found that the firm failed to report to ACT the correct symbol indicating whether the transaction was a buy or sell for transactions in eligible securities. The findings stated that the firm failed to report to ACT the correct number of shares for transactions in eligible securities and last sale reports of transactions in eligible securities. NASD also found that after a last sale report was submitted for the initial leg or legs of a riskless principal transaction, the firm failed to submit, for the offsetting riskless portion of the transaction, either a clearing only report with a capacity indicator of "riskless principal", or a non-tape, non-clearing report with a capacity indicator of "riskless principal." The findings further stated that the firm failed to submit required information to the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>)

and transmitted to OATS reports for transactions involving orders that contained inaccurate, incomplete, or improperly formatted date.

In addition, NASD found that the firm failed to provide written notification disclosing to its customer the firm's correct capacity in the transaction and made available a report on the covered orders in national market system securities that it received for execution from any person. The findings also stated that the report included incomplete and incorrect information in that the firm failed to include an eligible order and a partial execution of an eligible order in its published order execution statistics and the firm failed to publish accurate order execution statistics concerning average effective spreads. Moreover, NASD found that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning trade reporting (mixed capacity) and information barriers. NASD also determined that the firm failed to provide documentary evidence that it performed the supervisory reviews set forth in its written supervisory procedures concerning the requirements of trade reporting (riskless principal transactions) and information barriers. **(NASD Case #CMS040128)**

**Spear, Leeds & Kellogg, L.P. (CRD #3466, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$75,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report timely to OATS Reportable Order Events (ROEs). The findings also stated that the firm submitted to OATS reports with respect to equity securities traded on the NASDAQ Stock Market that were not in the electronic form prescribed by NASD and were repairable. The reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web site. The firm did not correct or replace any of the reports, resulting in an inaccurate and/or incomplete audit trail. NASD also found that the firm failed to report timely to OATS ROEs on behalf of reporting members. **(NASD Case #CMS040136)**

**Sterling Financial Investment Group, Inc. (CRD #41506, Boca Raton, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$175,000, and required to retain, within 60 days of acceptance of the AWC, an outside consultant to review and make recommendations concerning the adequacy of the firm's current policies and procedures as they relate to the firm's research department and e-mail retention practices. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it published and distributed a research report on a biopharmaceutical company with a sell/sell short recommendation on the company's common stock that contained substantive errors and other statements that made the report exaggerated, unwarranted, or misleading. The findings

also stated that the firm failed to make disclosures required by NASD Rule 2711(h) in a clear and prominent manner. NASD also found that despite the fact the firm had potential errors in the report brought to its attention, it published a "morning note" that repeated errors in the report and failed to disclose in the note that it made a market in the securities at the time the report was published. In addition, NASD found that the firm had no effective system in place to save e-mails or other electronic messages and failed to retain e-mails for three years or for the first two years in an accessible place. Furthermore, the findings stated that although the firm's research department director had been suspended in a principal or supervisory capacity, he performed acts that were principal or supervisory in nature during his suspension. Moreover, NASD found that the firm had no system or procedures in place to ensure compliance with regulatory suspensions generally or with the director's suspension specifically. (NASD Case #CAF040064)

**Transcend Capital, LP (CRD #104483, Austin, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report ROEs timely to OATS. The findings also stated that the firm failed to submit required information to OATS. (NASD Case #CMS040133)

## Individuals Barred or Suspended

**Marvin Ackerman (CRD #1580808, Registered Representative, Long Beach, 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, Ackerman consented to the described sanction and to the entry of findings that he misused the funds of a public customer in that he accepted checks totaling \$33,845.94 from the customer for investment purposes, deposited the funds into his daughter's bank account without obtaining the products as directed, and failed to use the funds for the benefit of the customer without her knowledge or consent. The findings also stated that Ackerman provided a public customer with a fabricated account statement showing that the customer had purchased \$52,492.04 shares/units of an annuity, when such shares had never been purchased on behalf of the customer. (NASD Case #CLI040022)

**Jonnie Layne Albin (CRD #2213211, Registered Representative, Norfolk, Nebraska)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Albin consented to the described sanction and to the entry of findings that, without the knowledge or consent of the firm, she converted \$90,800 from her member firm. (NASD Case #C04040041)

**Christopher Michael Andreach (CRD #2491323, Registered Representative, Fair Haven, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Andreach consented to the described sanctions and to the entry of findings that he signed the names of trustees on a letter of authorization for the transfer of a 401(K) plan without the knowledge, authorization, or consent of the trustees to an IRA account.

Andreach's suspension began September 7, 2004, and concluded at the close of business October 6, 2004. (NASD Case #C9B040081)

**Robert Paul Arnold (CRD #1817656, Registered Representative, East Greenwich, Rhode Island)** 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, Arnold consented to the described sanction and to the entry of findings that he billed \$44,646 of personal expenses to his corporate credit card without the knowledge or consent of his member firm. (NASD Case #C11040032)

**Thomas Michael Curtis (CRD #2903099, Registered Representative, Marina Del Rey, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$14,412 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Curtis reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Curtis consented to the described sanctions and to the entry of findings that he recommended the purchase of Class B mutual fund shares to public customers even though each fund also offered the same mutual fund investment in Class A shares, thereby depriving the customers of discounts on sales charges that they were entitled to receive through commission breakpoints, rights of accumulation, or letters of intent. The findings also stated that the Class B shares were subject to higher annual expenses than Class A shares and were subject to penalties should the customers redeem shares within six years of the purchase. NASD also found that Curtis made recommendations without having a reasonable basis to believe that the transactions were suitable for the customers in light of the nature of the transactions and the facts disclosed by the customers regarding their other securities holdings, financial situation, and needs.

Curtis' suspension began September 20, 2004, and will conclude at the close of business October 19, 2004. (NASD Case #C02040028)

**Eric Darrisaw (CRD #1425377, Registered Principal, Alexandria, Virginia)** submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any principal capacity for five business days. Without admitting or denying the allegations, Darrisaw consented to the described sanctions and to the entry of findings that he caused his member firm to fail to maintain a continuing and current education program for its registered persons in that the firm failed to evaluate and prioritize its training needs and develop a written training plan. The findings also stated that Darrisaw caused his member firm to fail to keep accurate and current its Form BD and failed to develop and implement a written anti-money laundering program reasonably designed to achieve and monitor its compliance with the requirements of the Bank Secrecy Act and the implementation regulations promulgated thereunder by the Department of the Treasury. NASD also found that Darrisaw caused his member firm to conduct a securities business without a properly qualified and registered FINOP and to file its 2002 annual audited financial report late.

Darrisaw's suspension began October 4, 2004, and concluded at the close of business October 8, 2004. (NASD Case #C07040055)

**Eric Harold Dieffenbach (CRD #1833420, Registered Representative, Littleton, Colorado) and Michel Antoine Rooms (CRD #2187994, Registered Representative, Littleton, Colorado)** were barred from association with any NASD member in any capacity. The NAC imposed the sanctions following appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that Dieffenbach and Rooms, prior to effecting transactions in the accounts of public customers, failed to provide any of the customers with a copy of the required Risk Disclosure Document and with complete information regarding the inside bid and ask quotations, and failed to tell the customers the amount of their compensation. The findings also stated that Dieffenbach and Rooms attempted to obstruct NASD's investigation of the penny stock trading violations by contacting and bribing customers into signing non-solicitation letters, backdated and altered certain of the non-solicitation letters before submitting them to NASD, and threatened and encouraged customers to lie to NASD.

Rooms has appealed this decision to the SEC, and the sanction against Rooms is not in effect pending consideration of the appeal. (NASD Case #C06020003)

**Richard Andrew Dimare (CRD #4353581, Registered Representative, Las Vegas, Nevada)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Dimare reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification.

Without admitting or denying the allegations, Dimare consented to the described sanctions and to the entry of findings that he failed to amend his Form U4 to disclose a material fact.

Dimare's suspension began September 20, 2004, and will conclude March 19, 2005. (NASD Case #C02040030)

**John Joseph Donadio (CRD #2924386, Registered Representative, Staten Island, New York)** 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, Donadio consented to the described sanction and to the entry of findings that he, directly or indirectly, by the use of any means or instrumentalities of interstate commerce or the mails or any facility of any national securities exchange, employed artifices, devices, or schemes to defraud; made untrue statements of material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or course of business that operated as a fraud or deceit. The findings also stated that Donadio effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive, or other fraudulent device or contrivance. Specifically, the findings stated that Donadio induced public customers to purchase 3,000 shares of stock in a company at a price of \$7.10 per share by falsely representing that the company had entered into an agreement to be acquired by another company and that the stock price would double within three to six weeks. The findings also stated Donadio failed to disclose that the company had virtually no assets or earnings and that its auditors had signed a warning in connection with the company's 2000 audit. (NASD Case #C10040064)

**James William Dreos (CRD #802681, Registered Representative, Scottsdale, Arizona)** was fined \$20,000 and suspended from association with any NASD member in any capacity for six months. The sanctions were based on findings that Dreos participated in private securities transactions for which he received compensation but failed to provide written notice to his member firm and failed to obtain written permission from his member firm to participate in the transactions.

Dreos' suspension began September 7, 2004, and will conclude March 6, 2005. (Case #C3A040017)

**Christopher Ryan Fardella (CRD #3028593, 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, Fardella consented to the described sanction and to the entry of findings that he was involved with the sale of promissory notes, the proceeds of which were to be used for the purpose of purchasing and

operating a member firm. The findings stated Fardella improperly received \$20,300 of the proceeds as loans. **(NASD Case #C9B040084)**

**Archie William Foor, III (CRD #1376005, Registered Representative, Yardley, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the allegations, Foor consented to the described sanctions and to the entry of findings that without the prior knowledge or authorization of public customers, he completed change of broker-dealer forms and new account forms for the customers, signed their names on the forms, and submitted the forms to his new member firm, which acted on the forms believing they were genuine.

Foor's suspension began September 20, 2004, and will conclude December 19, 2004. **(NASD Case #C9A040037)**

**Robert James Gallegos (CRD #3235311, Registered Representative, Albuquerque, New Mexico)** submitted a Letter of Acceptance, Waiver, and Consent in which he was ordered to pay \$14,000, plus interest, in restitution to a public customer and barred from association with any NASD member in any capacity. The restitution must be paid before Gallegos requests relief from any statutory disqualification. Without admitting or denying the allegations, Gallegos consented to the described sanctions and to the entry of findings that he obtained the control of, and held in his possession, \$22,500 belonging to a public customer, which he later returned to the customer. The findings also stated that Gallegos obtained and used for his own benefit \$14,000 belonging to a public customer, and that Gallegos failed to respond to NASD requests for information. **(NASD Case #C3A040037)**

**Rodney Kim Hartman (CRD #1339855, Registered Representative, St. George, Utah)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. The fine must be paid before Hartman reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hartman consented to the described sanctions and to the entry of findings that he exercised discretion in the account of a public customer without written authorization from the customer and without obtaining his firm's written acceptance of the account as discretionary.

Hartman's suspension began September 20, 2004, and concluded at the close of business October 1, 2004. **(NASD Case #C3A040039)**

**John Arthur Isham (CRD #2213222, Registered Representative, Garner, North Carolina)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Isham consented to the described sanction and to the entry of findings that he forged the signatures of public customers on "Amendment of Application and Statement of Health" forms. **(NASD Case #C07040068)**

**Thomas Michael Keating, Jr. (CRD #736904, Registered Representative, Glendale, Wisconsin)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Keating consented to the described sanctions and to the entry of findings that he engaged in outside business activity, for compensation, and failed to provide his member firm with prompt written notice.

Keating's suspension began October 4, 2004, and concluded at the close of business October 15, 2004. **(NASD Case #C8A040076)**

**Daniel Eric Kelsey (CRD #3031423, Registered Representative, Grand Rapids, Michigan)** was fined \$14,500, suspended from association with any NASD member in any capacity for 60 days, and ordered to requalify by exam as an investment company variable products representative within 60 days of the termination of his suspension. The fine shall become due and payable upon Kelsey's re-entry into the securities business. The sanctions were based on findings that Kelsey made material misrepresentations or omissions to public customers regarding his personal history and the concept of variable life insurance to induce their purchase of variable universal life insurance policies. The findings also stated that Kelsey made negligent misrepresentations to public customers concerning the required premium payments and the withdrawal or deposit of funds to variable life insurance policies. NASD also found that Kelsey failed to timely update his Form U4, filed a false Form U4, and willfully failed to disclose material information on his Form U4.

Kelsey's suspension began August 16, 2004, and concluded at the close of business October 14, 2004. **(NASD Case #C8A020088)**

**Mohit Anand Khanna (CRD #4156626, Registered Representative, San Diego, California)** submitted a Letter of Acceptance, Waiver, and Consent in which Khanna was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Khanna consented to the described sanction and to the entry of findings that he falsely represented to public customers, without his member firm's knowledge or consent, that his firm would refund sales

charges when mutual fund shares were sold after the customers had purchased approximately \$1.4 million of mutual fund Class A shares. The findings also stated that after Khanna made these false representations, the customers purchased approximately \$400,000 of additional Class A shares in their accounts. (NASD Case #C02040026)

**Dana Alexander Korosi (CRD #816161, Registered Representative, Moreland Hills, Ohio)** 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, Korosi consented to the described sanction and to the entry of findings that he converted \$188,398 from the securities account of a public customer by writing 60 checks made payable to himself, endorsed the checks and used the proceeds for his own benefit, or for the benefit of someone other than the customer, without the customer's knowledge, consent, or authorization. The findings also stated that Korosi failed to respond to NASD requests for information. (NASD Case #C8A040017)

**Craig Poy Lee (CRD #2680766, Registered Representative, South Elgin, Illinois)** submitted an Offer of Settlement in which he was barred from association with any NASD member firm any capacity. Without admitting or denying the allegations, Lee consented to the described sanction and to the entry of findings that he participated in private securities transactions, and failed to provide written notice to, or receive approval from, his member firm to participate in these activities. The findings also stated that Lee failed to respond to NASD requests for information. (NASD Case #C8A040065)

**Michael Douglas Lutey (CRD #4718604, Associated Person, Houston, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,500 and suspended from association with any NASD member in any capacity for 45 days. The fine must be paid before Lutey reassociates with a member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Lutey consented to the described sanctions and to the entry of findings that he failed to disclose material facts on his Form U4.

Lutey's suspension began September 20, 2004, and will conclude at the close of business November 3, 2004. (NASD Case #C06040028)

**Steven Paul Mednick (CRD #1386095, Registered Representative, East Northport, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$9,500, ordered to disgorge \$1,418, plus interest, in partial restitution to a public customer, and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations,

Mednick consented to the described sanctions and to the entry of findings that he recommended that public customers purchase municipal bonds primarily based on statements by his member firm and failed to perform his own independent research or investigation relating to the bonds. The findings also stated that Mednick did not have reasonable grounds for believing that his recommendations and resultant transactions were suitable for the financial situation, investment objectives, and needs of the customers.

Mednick's suspension began September 20, 2004, and concluded at the close of business October 1, 2004. (NASD Case #C10040093)

**Philip David Menard (CRD #1796404, Registered Representative, Germantown, Tennessee)** 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, Menard consented to the described sanction and to the entry of findings that he signed names of public customers to applications for variable annuities without the customers' knowledge or consent. The findings also stated that Menard then submitted each application to his member firm for approval and issuance by the insurance company. (NASD Case #C02040024)

**James Gary Morgan, Jr. (CRD #2976626, Registered Representative, Denton, Texas)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and required to pay \$29,000, plus interest, in restitution to public customers. Without admitting or denying the allegations, Morgan consented to the described sanctions and to the entry of findings that he fraudulently sold unsuitable securities to a public customer. The findings also stated that Morgan lied to NASD under oath during on-the-record testimony, and that he failed to amend his Form U4 to disclose material information. (NASD Case #CMS040048)

**Bernard Edward Nugent, Jr. (CRD #1209387, Registered Principal, Yarmouthport, Massachusetts)** 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 two months. Without admitting or denying the allegations, Nugent consented to the described sanctions and to the entry of findings that he recommended that a public customer liquidate approximately \$317,000 in mutual fund shares and purchase a variable annuity without having a reasonable basis for believing that the recommendation was suitable based on his client's investment objectives, financial situation, and needs.

Nugent's suspension began October 4, 2004, and will conclude at the close of business December 3, 2004. (NASD Case #C11040031)

**Daniel John O'Brien (CRD #1919816, Registered Representative, Missouri City, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, O'Brien consented to the described sanctions and to the entry of findings that he engaged in outside business activities by receiving \$46,447 in compensation for selling fixed annuities to public customers. The findings also stated that O'Brien failed and neglected to give prompt written notice of these activities to his member firm.

O'Brien's suspension began September 20, 2004, and concluded at the close of business October 1, 2004. **(NASD Case #C8A040073)**

**Carlos Julio Penalzoza (CRD #2187279, Registered Principal, Coral Gables, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500, and suspended from association with any NASD member in a principal capacity for 30 business days. Without admitting or denying the allegations, Penalzoza consented to the described sanctions and to the entry of findings that he permitted another individual of his member firm to act in the capacity of a general securities representative by effecting securities transactions without being registered as a general securities representative and to act in the capacity of a general securities principal by acting as a branch manager without being registered as a general securities principal.

Penalzoza's suspension began September 20, 2004, and will conclude at the close of business October 29, 2004. **(NASD Case #C10040091)**

**Michael A. Quinones (CRD #3027561, Associated Person, Brooklyn, New York)** was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Quinones consented to the described sanction and to the entry of findings that he willfully failed to disclose material information on his Form U4 and failed to respond to NASD requests for information. **(NASD Case #C10030113)**

**Christopher Michael Reno (CRD #2128187, Registered Representative, Staten Island, New York)** was barred from association with any member in any capacity. The sanction was based on findings that Reno failed to respond to NASD requests for information. The findings also stated that Reno engaged in unauthorized purchase transactions in the accounts of public customers without prior authorization or consent of the customers. **(NASD Case #C9B040004)**

**Ileana Rodriguez (CRD #2834408, Registered Representative, Miami, Florida)** 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, Rodriguez consented to the described sanction and to the entry of findings that she misrepresented material information to a public customer in a written investment proposal. The findings also stated that Rodriguez failed to respond to NASD requests for information. **(NASD Case #C07040070)**

**Charles Anthony Sacco (CRD #2762595, Registered Representative, Medford, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for one year. In light of the financial status of Sacco, no monetary sanction has been imposed. Without admitting or denying the allegations, Sacco consented to the described sanctions and to the entry of findings that he maintained relationships with certain clients, including hedge funds, that engaged in the "market timing" of mutual funds. The findings also stated that Sacco established a number of accounts for each of his market-timing customers and obtained various consultant numbers from his member firm to maximize for each customer the number of exchanges permitted by the mutual fund complexes before the customers' trading was blocked by the mutual fund complexes. NASD also found that Sacco established another financial consultant number using his and another person's initials to resume trading at a particular mutual fund complex and avoid restrictions placed on his trading activities.

Sacco's suspension began September 20, 2004, and will conclude at the close of business September 19, 2005. **(NASD Case #C11040033)**

**Lucas Charles Schell (CRD #4290983, Registered Representative, Coeur d'Alene, Idaho)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Schell reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Schell consented to the described sanctions and to the entry of findings that he affixed the signature of a public customer to an Application for Policy Change/Reinstatement directed to an insurance company to reinstate the customer's life insurance policy without the authorization or consent of the customer.

Schell's suspension began September 20, 2004, and will conclude March 19, 2005. **(NASD Case #C3B040023)**

**Edward Lee Sensor (CRD #1969463, Registered Principal, Sterling Illinois)** was barred from association with any NASD member firm in any capacity. The sanction was based on findings that Sensor failed to respond to NASD requests for information. The findings also stated that Sensor engaged in private securities transactions without giving prior written notice to, or obtaining prior written approval from, his member firm.

NASD also found that Sensor engaged in an outside business activity without providing prompt written notice to his member firm. (NASD Case #C8A040010)

**Wayne Davis Shook (CRD #2837213, Registered Representative, Old Orchard Beach, Maine)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for one year. In light of the financial status of Shook, no monetary sanction was imposed. Without admitting or denying the allegations, Shook consented to the described sanction and to the entry of findings that he executed transactions in the account of a public customer without reasonable grounds for believing that the level of activity represented by such transactions was suitable for the customer on the basis of her financial condition, investment, objectives, and needs. The findings also stated that Shook exercised effective control over the customer's account, engaging in trading activity that was excessive in size and frequency, trading on margin in the customer's account, and effecting purchases in the account costing approximately \$191,178 that corresponded to an annualized turnover rate of approximately 12 times.

Shook's suspension began September 20, 2004, and will conclude at the close of business September 19, 2005. (NASD Case #C8A040047)

**Rick Christopher Siskey (CRD #1463173, Registered Representative, Charlotte, North Carolina)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Siskey reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Siskey consented to the described sanctions and to the entry of findings that he engaged in private securities transactions and failed to provide sufficient prior written notice to his member firm.

Siskey's suspension began September 20, 2004, and will conclude at the close of business September 19, 2006. (NASD Case #C07040075)

**Leon Harry Strohecker, III (CRD #2829676, Registered Representative, Whitmore Lake, 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, Strohecker consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form U4. (NASD Case #C9A040036)

**Jan Miguel Tapia (CRD #1047359, Registered Principal, Staten Island, New York)** 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, Tapia consented to the described sanction and to the entry of findings that he received a \$100,000 check from a public customer for investment purposes and did not deposit or apply the funds as instructed. NASD also found that Tapia wired, or caused to be wired, \$98,128.08 from a public customer's securities account to accounts in which Tapia and/or his wife had beneficial interest using false letters of authorization to effect the transfers without the knowledge, authorization, or consent of the customer. The findings also stated that Tapia failed to respond to NASD requests for information. (NASD Case #C10040047)

**Stephen Nicholas Thomas (CRD #3236045, Registered Representative, Queens, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Thomas made improper use of public customer funds. (NASD Case #C10030082)

**Ronald James Turner (CRD #2735639, 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, Turner consented to the described sanction and to the entry of findings that he made improper use of proceeds from the sale of promissory notes. The findings also stated that Turner failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C9B040083)

**Brian Michael Uhelski (CRD #2807010, Registered Principal, Mason, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Uhelski consented to the described sanction and to the entry of findings that he participated in outside business activities without providing prompt written notice to his member firm. (NASD Case #C8A040077)

**Karen Taxacher Wardlaw (CRD #800300, Registered Representative, Plantation, Florida)** 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, Wardlaw consented to the described sanction and to the entry of findings that she failed to respond to an NASD request for information. (NASD Case #C07040076)

**Ronald Dean Wightman (CRD #466601, Registered Principal, Salt Lake City, Utah)** submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any supervisory capacity

for 30 days. Without admitting or denying the allegations, Wightman consented to the described sanctions and to the entry of findings that he failed to supervise a registered representative in a manner reasonably designed to achieve compliance with Rule 3040.

Wightman's suspension began October 4, 2004, and will conclude at the close of business November 2, 2004. (NASD Case #C02040016)

## Decisions Issued

The District Business Conduct Committee (DBCC) or the OHO have issued the following and have been appealed to or called for review by the NAC as of September 3, 2004. 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*.

**Herbert Ivan Kay (CRD #1374570, Registered Principal, Tucson, Arizona)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Kay participated in private securities transactions without prior written notice to, or approval from, his member firm to participate in the transactions.

This decision has been appealed to the NAC, and the sanction is not in effect pending consideration of the review. (NASD Case #C3A030015)

**Richard Leon Newberg (CRD #346857, Registered Principal, Golden Beach, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Newberg provided false testimony during an NASD hearing.

This decision has been appealed to the NAC, and the sanction is not in effect pending consideration of the appeal. (NASD Case #CAF030013)

**Andrew Paul Schneider (CRD #2907279, Registered Representative, West Palm Beach, Florida)** was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. The sanctions were based on findings that Schneider engaged in outside business activity without providing his member firm with prompt written notice.

This decision has been appealed by the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C10030088)

## Complaints Filed

NASD issued the following complaints. 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.

**Dana Niles Frankfort (CRD #2243930, Registered Representative, Marina Del Rey, California)** was named as a respondent in an NASD complaint alleging that he instructed an individual to authorize and pay the full amount of a limited partner's initial investment in a limited partnership without regard to the net profit or loss or the relative value of the partner's account, resulting in the account being reduced to a \$0 balance and constituting a re-purchase by the limited partnership of the individual's partnership interest in contravention of the representations in the private placement memorandum. The complaint also alleges that this payment caused the remaining limited partners to suffer losses in the value of their interests unrelated to market returns, and Frankfort failed to notify the other partners that the partnership had re-purchased the interest of the one individual and that the partnership had suffered significant market losses since its inception.

In addition, the complaint alleges that Frankfort, in connection with the sale of limited partnership interests and with the purchase of one customer's limited partnership interest, with scienter, directly or indirectly, by the use of 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 true, in light of the circumstances under which they were made, not misleading; and engaged in acts, practices, or courses of business that operated or would operate as a fraud or deceit upon purchasers or prospective purchasers. Furthermore, the complaint alleges that Frankfort made recommendations to public customers to purchase limited partnership interests without a reasonable basis and failed to conduct due diligence prior to making the recommendations. Moreover, the complaint alleges that Frankfort made the recommendations when he knew, or should have known, that the fund manager had no prior experience in managing investment funds for the benefit of public customers and made the recommendations without having reasonable grounds for believing the recommendations and resultant transactions were suitable for the customers on the basis of their financial situation and needs. The complaint also alleges that Frankfort participated in private securities transactions without prior written notification to, and written approval from, his member firm. (NASD Case #C02040032)

Dupont Securities Group, Inc. (CRD #42305, New York, New York) and David Wayne Parsons (CRD #2963654, Registered Principal, New York, New York) were named as respondents in an NASD complaint alleging that the firm and Parsons engaged in unlawful sales of unregistered shares of a common stock of the publicly traded parent company of the firm because there was no registration statement filed or in effect pursuant to Section 5 of the Securities Act of 1933. The complaint also alleges that the firm issued press releases that were materially false and misleading and Parsons knew or was reckless in not knowing that the press releases and other communications were false and misleading but allowed the information to be disseminated to the public. In addition, the complaint alleges that the issuance of the false and misleading press releases and other conduct by the firm were intended to, and did, artificially inflate the price of the common stock, thereby defrauding investors. Furthermore, the complaint alleges that Parsons willfully misrepresented on his Form U4 that his authorization to act as an attorney had never been revoked or suspended when, in fact, it had been and provided legal advice with respect to securities transactions when he was not licensed to practice law. Moreover, the complaint alleges that during sworn testimony, Parsons refused to answer questions based on assertions of attorney-client privilege that were false because he could not lawfully assert such a privilege as he was not licensed to practice law in any state. (NASD Case #CAF040068)

Samuel Davis Hughes (CRD #1928041, Registered Representative, Panama City, Florida) was named as a respondent in an NASD complaint alleging that he recommended and effected transactions in the accounts of public customers without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customers based on the customers' financial situations, investment objectives, and needs. In addition, the complaint alleges that Hughes failed to disclose to a customer that surrender charges would be assessed for sales and misrepresented that a customer would receive a bonus payment for annuity purchases. The complaint also alleges that Hughes reallocated a public customer's funds without their knowledge or authorization and failed to respond to NASD requests to appear for testimony. (NASD Case #C07040067)

Jayne Alexander Kurtyka (CRD #1171623, Registered Representative, W. Chicago, Illinois) was named as a respondent in an NASD complaint alleging that he recommended and effected securities transactions in the account of a public customer, including purchasing securities on margin, without having a reasonable basis for believing that the recommendations and resultant transactions were suitable for the customer based upon the customer's age, total net worth, liquid net worth, investment experience, financial situation, and investment objectives. The complaint also alleges that Kurtyka exercised discretion in the account of a public customer without

obtaining written authorization from the customer and written acceptance of the account as discretionary by his member firm. In addition, the complaint alleges that Kurtyka prepared and mailed, or caused to be prepared and mailed, a form letter considered by NASD to be sales literature that was not fair and balanced and omitted material facts or qualification, causing the form letter to be misleading or containing exaggerated, unwarranted, or misleading statements or claims. The complaint further alleges that the form letter failed to provide a fair and balanced presentation in that it failed to disclose the material differences between the general nature of the fund's portfolio and securities indexes against which it was compared. (NASD Case #CAF040067)

Sterling Scott Lee (CRD #1848950, Registered Principal, Austin, Texas) and Dennis Todd Lloyd Gordon (CRD #1614614, Registered Principal, Houston, Texas) were named as respondents in an NASD complaint alleging that they permitted an individual to function as an unregistered principal of a member firm for over three years. The complaint also alleges that Lee and Gordon knew, or should have known, that the individual was not registered in any capacity. The complaint further alleges that Lee and Gordon, acting on behalf of their member firm, charged its customers prices for an equity security that were not fair and reasonable based on all relevant circumstances, including market conditions with respect to such security at the time of the transactions, the expenses involved, and the fact that his firm was entitled to a profit. They also failed to disclose the mark-ups on customer confirmation statements. (NASD Case #C06040027)

Rick Lee Matney (CRD #1828590, Registered Representative, Marshalltown, Iowa) was named as a respondent in an NASD complaint alleging that Matney received a check totaling \$2,018.80 from a public customer to cover property and casualty insurance on certain properties. The complaint alleges that Matney discovered that his insurance company would not underwrite the insurance that Matney had verbally committed to in his conversation with the customer, did not relay this information to the customer, and applied the \$2,018.80 check to premiums for existing insurance policies held by the customer. The complaint also alleges that the customer requested details on the property and casualty insurance that she had purchased through Matney, including the cost and coverage amounts of each policy, and Matney created insurance declarations pages for property and casualty insurance purportedly underwritten by his insurance company. However, the property and casualty insurance reflected in the declarations pages was not underwritten by his insurance company. In addition, the complaint alleges that Matney fabricated this information to satisfy the customer's request. (NASD Case #C04040036)

**Anthony Stephen McComas (CRD #708707, Registered Representative, Guaynabo, Puerto Rico)** was named as a respondent in an NASD complaint alleging that he caused \$466,827 in checks to be issued from a public customer's securities account, which he deposited into a bank account that he controlled without the knowledge or authorization of the customer. The complaint also alleges that McComas failed to respond to NASD requests for information. **(NASD Case #C07040072)**

**Jamie Patrick McNamara (CRD #4546647, Registered Representative, Lees Summit, Missouri)** was named as a respondent in an NASD complaint alleging that he received a \$388 money order from a public customer payable to his member firm to obtain automobile insurance coverage. The complaint alleges that McNamara deposited the funds into a personal d/b/a account and did not purchase the automobile insurance coverage for the customer as requested. The complaint also alleges that the customer requested details on the automobile coverage that she had requested and believed she had purchased, and McNamara created a fictitious automobile insurance card and provided it to the customer. In addition, the complaint alleges that McNamara failed to respond to NASD requests for information. **(NASD Case #C04040040)**

**Nicholas Harrel Patton, Jr. (CRD #1545508, Registered Supervisor, Little Rock, Arizona)** was named as a respondent in an NASD complaint alleging that Patton received checks totaling \$27,214.25 from public customers to invest in securities. The complaint alleges that Patton failed and neglected to remit these funds to his member firm, and, instead, deposited the checks into his personal bank checking account without the customers' knowledge or consent, thereby converting the customers' funds. The complaint also alleges that Patton failed to respond to NASD requests for information. **(NASD Case #C05040063)**

**Rick James Settles (CRD #1559298, Registered Principal, Louisville, Kentucky)** was named as a respondent in an NASD complaint alleging that Settles recommended and effected purchase and sales transactions in the accounts of public customers without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customers on the basis of their financial situations and needs. The complaint also alleges that Settles exercised discretionary authority in the accounts of public customers without having obtained prior written acceptance of the accounts as discretionary by his member firm. **(NASD Case #C05040062)**

## **Firms Fined, Individuals Sanctioned**

**EDI Financial, Inc. (CRD #15699, Dallas, Texas) and Martin William Prinz (CRD #1330601, Registered Principal, Southlake, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which they were fined \$25,000, jointly and severally. Additionally, the firm was censured and Prinz was suspended from association with any NASD member in any principal capacity for 30 business days. Without admitting or denying the allegations, the firm and Prinz consented to the described sanctions and to the entry of findings that the firm, acting through Prinz, engaged in a securities business when the firm's net capital was below the minimum requirement and failed to accurately file FOCUS Part IIA reports. The findings also stated that the firm, acting through Prinz, failed to keep current its general ledger and trial balance, failed to have a financial and operations principal (FINOP), and maintained the NASD registration of the firm's former FINOP who was not involved in the financial and operational management of the firm. In addition, NASD found that the firm, acting through Prinz, failed to establish and maintain a system to supervise the activities of an owner of the firm who was performing duties requiring registration as a FINOP but was not registered as a FINOP; and failed to establish and maintain a system to supervise, including the establishment and maintenance of written procedures, the accuracy and maintenance of the firm's financial books and records so as to ensure the firm complied with all aspects of the net capital rule.

Prinz' suspension began October 18, 2004, and will conclude at the close of business November 29, 2004. **(NASD Case #C06040026)**

**Kirlin Securities, Incorporated (CRD #21210, Syosset, New York), Anthony Joseph Kirincic (CRD #1499511, Registered Principal, Dix Hills, New York), AiLin Khoo Dorsey (CRD #2198636, Registered Principal, South San Francisco, California), Paul Thomas Garvey (CRD #1214388, Registered Representative, Orinda, California), and Brian Francis McEnergy (CRD #2735200, Registered Representative, San Francisco, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured; fined \$155,800; ordered to pay \$1,044,732.35 in restitution to public customers, \$26,185.39 jointly and severally with Garvey, and \$48,107.99 jointly and severally with McEnergy; ordered to file all sales literature and advertising with NASD's Advertising Regulation Department at least 10 days prior to their first use for one year from the date of acceptance by the National Adjudicatory Council (NAC) of the Letter of Acceptance, Waiver, and Consent (AWC); and ordered to retain an independent consultant to review and make recommendations concerning the adequacy of the firm's supervisory and operating procedures as they relate to review of advertising and sales literature, books and recordkeeping, corporate debt, municipal securities, and equity

transactions, including markups, markdowns, and commissions charged. Kirincic was fined \$25,000 and suspended from association with any NASD member as a Series 24 (General Securities Principal) for 30 days. Dorsey was fined \$15,000 and suspended from association with any NASD member in a principal or supervisory capacity for 20 business days. Garvey was fined \$10,000 and suspended from association with any NASD member in any capacity for 14 days. McEnery was censured and fined \$10,000.

Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm, acting through its employees, participated, directly or indirectly, in undertakings involving the sale of and interest in Brady Bonds with a view to the distribution of such securities and acted as underwriters of the securities in violation of Section 5 of the Securities Act of 1933. The findings also stated that the firm, acting through its employees, developed and disseminated to the public advertising materials that failed to disclose material facts regarding the Brady Bonds and included exaggerated, unwarranted, or misleading statements or claims about the Brady Bonds. NASD also found that the firm, acting through its employees, failed to determine markups on the basis of the firm's contemporaneous costs, thereby charging its retail customers fraudulently excessive markups. In addition, NASD found that the firm, acting through Kirincic, failed to establish and maintain an adequate supervisory system in connection with the advertising, sale, and distribution of Brady Bonds. NASD found that written procedures failed to identify how the firm's principals were to review transactions for excessive pricing and markups, when such a review should take place, and how to determine markups if the firm was dominating and controlling the trading of a security. Furthermore, NASD found that the firm, acting through Kirincic, failed to maintain either hard or electronic copies of Brady Bond inventory sheets and discarded the sheets on a daily basis.

NASD found that the firm, through its employees, obtained undisclosed profits in transactions with public customers by taking positions to match customer orders and then executing the customer orders as principal transactions later in the same day, taking the intra-day profits from the transactions for itself. In addition, NASD found that the firm and its employees failed to give public customers best execution on trades when it took "trading profits" and when it executed principal transactions at prices less favorable than the prevailing inter-dealer price at the time of the trade. NASD also found that the firm failed to maintain books and records; failed to maintain trading tickets of customer's transactions; failed to maintain accurate records of the time of receipt of the customer's orders and the instructions the customer gave in making the orders; failed to make and keep memoranda of each order; failed to mark limit orders and market orders with restrictions and the conditions of each order and trading tickets; failed to accurately

record the terms and conditions on the customer's limit orders; and failed to keep identifiable contemporaneous records showing whether an order was a market order or a limit order. Furthermore, NASD found that the firm's records failed to reflect unsolicited orders; that time stamps on orders failed to reflect the time the customer placed the order; that the firm reported transactions before it time-stamped order tickets and executed the transactions before it time-stamped the orders as received; that the firm sent confirmations to public customers that failed to disclose profits the firm received; that the firm treated trades with customers in which it did not take secret profits as riskless principal transactions but provided the customers with confirmations describing them inaccurately as principal transactions; and that, in agency cross trades, the firm sent customers confirmations that failed to disclose the amount of all commission or remuneration and either the name of the person from whom the security was purchased, to whom it was sold, or the fact that such information would be furnished upon request.

NASD also found that the firm reported or confirmed the trades as principal transactions and did not submit either a clearing-only report or a non-tape, non-clearing report in principal trades with public customers in which the firm did not take undisclosed profits; reported trades as principal transactions even though the trades were riskless cross trades; failed to submit or confirm trades with customers to ACT; and reported one transaction more than 90 seconds after execution. In addition, NASD found that the firm failed to establish and maintain supervisory procedures reasonably designed to achieve compliance with federal securities laws and NASD rules relating to interpositioning, front-running, best execution, books and records, and trade reporting requirements. The findings also stated that the firm failed to designate principals with supervisory responsibility for interpositioning and for implementing procedures when front-running was detected. NASD found that Dorsey failed in her supervisory duties in her review of documents and knew or should have known that the majority of customer trades involved large undisclosed concessions taken by the firm in addition to commissions, markups, or markdowns, and failed to make reasonable inquiry into the transactions or conduct adequate follow-up.

Furthermore, NASD found that the firm, Garvey, and McEnery charged excessive amounts on principal transactions and failed to take into account factors identified in NASD Rule IM-2440 that should be considered in determining the fairness of charges. Dorsey, as a registered principal, reviewed and approved the amount charged on each of the transactions. Moreover, the firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with NASD rules relating to charges to customers and failed to reflect how the factors enumerated in NASD Rule IM-2440 should be taken into account. Dorsey, as the registered principal responsible for

reviewing and approving the amount charged on transactions failed to take appropriate action to ensure that the firm's charges to customers were reasonable.

Moreover, NASD found that the firm failed to conduct an annual review of an Office of Supervisory Jurisdiction and failed to report, and to report timely, statistical and summary information regarding written customer complaints pursuant to NASD Rule 3070. In addition, NASD found that the firm, acting through its employees, failed to enforce the firm's procedures relating to its review of corporate debt, municipal transactions, and equity securities transactions. The findings also stated that Kirincic failed to enforce or delegate the responsibility of enforcing the firm's procedures relating to review of equity securities transactions. NASD also found that the firm failed to properly notate whether a sale was "long" or "short" on order memoranda for sell transactions; failed to report properly certain equity security transactions in a timely manner with all correct modifiers; failed to report correctly the price at which transactions were executed; and failed to report transactions reviewed to the Fixed Income Pricing (FIPS) reporting system.

Kirincic's suspension began September 20, 2004, and will conclude at the close of business October 19, 2004. Dorsey's suspension began September 20, 2004, and concluded at the close of business October 15, 2004. Garvey's suspension began September 20, 2004, and concluded October 3, 2004. (NASD Case #CAF040063)

## Firms and Individuals Fined

**American National Municipal Corporation (CRD #44860, Woodland Hills, California) and John Thomas Ford (CRD #2206110, Registered Principal, Fillmore, California)** 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 firm and Ford consented to the described sanctions and to the entry of findings that the firm, acting through Ford, failed to report timely statistical and summary information concerning customer complaints to NASD pursuant to NASD Rule 3070c. (NASD Case #C02040034)

**Austin Securities, Inc. (CRD #17094, Forest Hills, New York) and Brian Robert Mitchell (CRD #1191608, Registered Principal, Yorktown Heights, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$14,000, jointly and severally. Without admitting or denying the allegations, the firm and Mitchell consented to the described sanctions and to the entry of findings that the firm, acting through Mitchell, permitted an individual to act in a capacity that required registration while the individual's

registration status with NASD was inactive due to his failure to complete the Regulatory Element of NASD's Continuing Education Requirement. The findings also stated that the firm, acting through Mitchell, allowed another individual to maintain his registration as a general securities representative through his purported association with the firm when, in fact, he was not actively involved in the firm's securities business or otherwise functioning as a representative of the firm. (NASD Case #C10040094)

**Bossio Financial Group, Inc. (CRD #43970, Wixom, Michigan) and Alan John Bossio (CRD #2502983, Registered Principal, Farmington Hills, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$13,000, jointly and severally, and the firm was fined an additional \$2,500. Without admitting or denying the allegations, the firm and Bossio consented to the described sanctions and to the entry of findings that the firm commenced an offering of 2,000,000 shares of series C convertible preferred stock (Share) through the use of a private placement memorandum. The memorandum represented that the offering was contingent upon the subscription of a minimum number of Shares. The findings also stated that the memorandum further represented that if the condition was not satisfied, none of the Shares would be sold, the investor's funds would be returned without any reduction, and that all subscription funds would be held in a "segregated, interest bearing escrow account" by the firm and "will not be released to the company (or any selling commissions or finder's fees paid) until at least \$500,000 of the Shares are sold." The document further stated that "unless at least \$500,000 of Shares are sold by the Offering Termination Date, all of the investors' funds and interest earned thereon while they were deposited into that escrow account will be returned to them" by the firm. NASD found that the firm sold Shares of the security to members of the public and the customer's funds were deposited into a bank account in the name of the company and the signators on the segregated account were Bossio and another individual.

In addition, NASD determined that the firm, acting through Bossio, permitted the release of \$130,000 before the firm collected \$500,000 from investors. The findings also included that, in connection with the sale of the shares, the firm, acting through Bossio, rendered false and misleading representations in the memorandum and subscription agreement that the purchaser's funds would be held in a segregated, interest-bearing escrow account and would not be released to a company (or any selling commissions or finder's fees paid) until at least \$500,000 of Shares were sold, in that the firm, acting through Bossio, failed to properly escrow purchasers' funds in a segregated account from June 28, 2002 to July 11, 2002, and improperly forwarded the funds to the company prior to the collection of the required minimum purchases. The findings also

stated that the firm used the mails or other means or instrumentalities of interstate commerce to effect transactions in securities, or received and held customer funds or securities, while the firm failed to maintain the minimum required net capital.

Moreover, NASD found that the firm filed with NASD a FOCUS Part IIA Report that was inaccurate in that, among other things, the report overstated the firm's net capital. NASD found that the firm received funds from public customers for the purchase of shares of securities and held the funds in a bank account that was, in part, controlled by Bossio; while pursuant to the membership agreement, the firm agreed that it would not hold customer funds and operate pursuant to the exemptive provisions of SEC Rule 15c3-3(k)(2)(i). The findings stated that the firm, acting through Bossio, received and held customer funds in a bank account while failing to open and use a special reserve bank account for the exclusive benefit of customers that meets the requirements of SEC Rule 15c3-3(f), and failed to compute the member's special reserve requirement pursuant to SEC Rule 15c3-3. (NASD Case C8A040074)

**Brookstreet Securities Corporation (CRD #14667, Irvine, California) and Stanley Clifton Brooks (CRD #31684, Registered Principal, San Clemente, California)** submitted a Letter of Acceptance, Waiver, and Consent in which they were censured and fined \$10,000, jointly and severally. The firm was also required to demonstrate to NASD within 90 days of acceptance of the AWC that it had established procedures for the review and investigation by a designated principal of all information reflected on the Uniform Application for Securities Industry Registration or Transfer (Form U4) submitted by each applicant to the firm for association as a registered or associated person. Without admitting or denying the allegations, the firm and Brooks consented to the described sanctions and to the entry of findings that the firm, acting through Brooks, had sufficient information to raise concerns about whether a registered representative's activities were in compliance with NASD rules pertaining to private securities transactions, but Brooks failed to supervise the representative in a manner reasonably calculated to prevent violation of NASD rules. (NASD Case #C02040031)

**Cardinal Capital Management, Inc., (CRD #24605, Miami, Florida) and Christopher Alan Sweeney (CRD #823375, Registered Principal, Palm City, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$18,500, jointly and severally, of which \$12,500, is jointly and severally with Sweeney. Sweeney was also censured. Without admitting or denying the allegations, the firm and Sweeney consented to the described sanctions and to the entry of findings that the firm failed to maintain correspondence of its registered representatives relating to its investment banking or securities business. NASD also found that the firm, acting through Sweeney, failed to prepare a written needs analysis and

training plan for the calendar year 2000 and further permitted at least two representatives to act in registered capacities while their registrations were inactive due to their failures to satisfy the Regulatory Element of their Continuing Education Requirements. The findings also stated that the firm conducted a securities business while it failed to maintain its required net capital, inaccurately calculated its net capital, maintained inaccurate books and records, and filed inaccurate FOCUS reports. In addition, NASD determined that the firm, acting through Sweeney, filed five quarterly reports in an untimely manner. (NASD Case #C07040073)

**FEA, Inc. (CRD #24376, Northbrook, Illinois) and John Herman Cox (CRD #1944308, Registered Principal, Glenview, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm and Cox were censured and fined \$12,500, jointly and severally, and the firm was fined an additional \$2,500. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm used the mails or other means or instrumentalities of interstate commerce to effect transactions in securities, or received and held customer funds or securities while the firm failed to maintain the minimum required net capital. The findings also stated that the firm failed to comply with the terms of its membership agreement when it received funds from public customers for the purchase of interests in securities and held the funds in a bank account controlled by Cox while pursuant to the Membership Agreement, the firm and Cox agreed that it would not hold customer funds and operate pursuant to the exemptive provisions of SEC Rule 15c3-3(k)(2)(i).

NASD also found that the firm, acting through Cox, received and held public customer funds in bank accounts while failing to open and use a special reserve bank account for the exclusive benefit of customers and failed to compute the firm's special reserve requirement pursuant to SEC Rule 15c3-3 as of month-end and withdrawal dates. In addition, NASD determined that the firm commenced an offering of limited partnership interests through the use of private placement memorandum at a price of \$50,000 per unit. The memorandum represented that the offering was contingent upon the number of subscription units by the termination of the offering with the right to extend the offering for an additional 30 days or "all subscriptions received will be promptly refunded to subscribers without interest, charge or deduction". The memorandum further represented that payments received from subscribers would be held in a demand deposit escrow account and would not be commingled with any other funds. NASD found that the firm, acting through Cox, failed to promptly return the subscribers' funds or obtain written reconfirmations of the offerings from the existing subscribers by the due date; such failure rendered the representation in the Memorandum and Subscription Agreement false and misleading. The findings also stated that the firm commenced an offering of securities, through the use of Private

Placement Memorandum at a price of \$50,000 per unit. The memorandum represented that the offering was contingent upon the number of subscription units by the termination of the offering with the right to extend the offering for an additional 30 days, or "all subscriptions received will be promptly refunded to subscribers without interest, charge or deduction." The memorandum further represented that payments received from subscribers would be held in a demand deposit escrow account pending termination of the offering and would not be commingled with any other funds. Moreover, the findings stated that the memorandum represented that the "General Partner and its affiliates reserve the right to purchase units at any time during the offering, and be treated as a Class A Limited Partner. Such purchase may not be for investment, but may be with a view towards resale or distribution of the units so acquired in accordance with applicable law." NASD found that Cox purchased seven units for \$350,000 to achieve the required minimum amount necessary to release the funds and forward the securities. While the memorandum disclosed the fact that Cox could purchase units of securities, it failed to disclose the total amount of units that the general partner and its affiliates could purchase and that the purchases would be for investment, not resale, rendering the Memorandum as false and misleading. (NASD Case #C8A040075)

**Shields and Company (CRD #11053, New York, New York) and John Patrick Hughes, Jr. (CRD #2486574, Registered Representative, Hasbrouck, New Jersey)** submitted an Offer of Settlement in which they were censured and fined \$20,000, jointly and severally. Without admitting or denying the allegations, the firm and Hughes consented to the described sanctions and to the entry of findings that the firm, acting through Hughes, failed to establish and maintain a reasonably designed supervisory system. (NASD Case #C07040064)

**Centaurus Financial, Inc. (CRD #30833, Orange, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000, \$5,000 of which was jointly and severally. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to file timely a report regarding events required to be disclosed pursuant to NASD Rule 3070(b) and a report concerning statistical and summary information relating to customer complaints pursuant to NASD Rule 3070(c). (NASD Case #C02040029)

**Deutsche Bank Securities, Inc. (CRD #2525, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it incorrectly reported to the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) "at-risk" principal transactions in NASDAQ National Market<sup>®</sup> (NNM<sup>®</sup>) securities as non-media with a "riskless principal" capacity. The findings also stated that the firm failed

to submit, for the offsetting, a "riskless" portion of "riskless" principal transactions in NNM securities, either a clearing-only report with a capacity indicator of "riskless principal," or a non-tape, non-clearing report with a capacity indicator of "riskless principal." The findings further stated that the firm failed to report to ACT the correct price for a "riskless principal" transaction. In addition, NASD found that the firm failed to provide written notification disclosing to its customer that the transactions were executed at an average price and incorrectly documented the average price disclosure on three occasions. (NASD Case #CMS040137)

**Donaldson, Lufkin & Jenrette Securities Corp. (CRD #816, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$100,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to establish and maintain a supervisory system and written supervisory procedures designed to ensure that a registered representative complied with all applicable securities laws, regulations, and NASD rules in his role as the portfolio manager of a limited partnership. The findings also stated that although several of the firm's principals knew that the representative was managing partnership assets and was soliciting brokerage clients to become investors in the partnership, the firm failed to designate a principal and failed to develop written supervisory procedures for the partnership to supervise the representative's activities. NASD also found that the firm failed to ensure that procedures were in place to review the distribution of quarterly performance reports and written commentary prepared by the representative for the limited partners. (NASD Case #CAF040066)

**First New York Securities, L.L.C. (CRD #16362, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to file Large Option Position Reports (LOPRs) with NASD to report positions of conventional option contracts. (NASD Case #CMS040127)

**Garden State Securities, Inc. (CRD #10083, Wall, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it did not report trades within the required 90 seconds and did not report the trades as late trades utilizing the .SLD modifier. The findings also stated that the firm failed to ensure that the business clocks it utilized for trade reporting purposes were synchronized in conformity with NASD rules. NASD also found that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to ensure compliance with ACT reporting rules. (NASD Case #C9B040082)

**Murphy & Durieu (CRD #6292, 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, regulations, and NASD rules concerning ACT trade reporting within 30 business days. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through ACT last sale reports of transactions in OTC equity securities and failed to designate through ACT such last sale reports as late. The findings further stated that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning ACT trade reporting. **(NASD Case #CMS040130)**

**National Clearing Corp. (CRD #14343, Beverly Hills, California)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it failed to file settlement and award disclosures; failed to file a disclosure regarding an internal disciplinary action; and failed to file a settlement disclosure in a timely manner pursuant to NASD Rule 3070(b). The findings also stated that the firm failed to file, and to file timely, quarterly reports concerning statistical and summary information relating to customer complaints pursuant to NASD Rule 3070(c). NASD also found that the firm failed to report accurately to the Municipal Securities Rulemaking Board (MSRB) the correct time of execution regarding reported transactions and failed to report customer transactions to the MSRB. **(NASD Case #C02040027)**

**Prudential Equity Group, LLC (CRD #7471, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$30,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short sale transactions and failed to report each of these transactions to ACT with a short sale modifier. NASD found that the firm failed to report to ACT the correct symbol indicating whether the transaction was a buy or sell for transactions in eligible securities. The findings stated that the firm failed to report to ACT the correct number of shares for transactions in eligible securities and last sale reports of transactions in eligible securities. NASD also found that after a last sale report was submitted for the initial leg or legs of a riskless principal transaction, the firm failed to submit, for the offsetting riskless portion of the transaction, either a clearing only report with a capacity indicator of "riskless principal", or a non-tape, non-clearing report with a capacity indicator of "riskless principal." The findings further stated that the firm failed to submit required information to the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>)

and transmitted to OATS reports for transactions involving orders that contained inaccurate, incomplete, or improperly formatted date.

In addition, NASD found that the firm failed to provide written notification disclosing to its customer the firm's correct capacity in the transaction and made available a report on the covered orders in national market system securities that it received for execution from any person. The findings also stated that the report included incomplete and incorrect information in that the firm failed to include an eligible order and a partial execution of an eligible order in its published order execution statistics and the firm failed to publish accurate order execution statistics concerning average effective spreads. Moreover, NASD found that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning trade reporting (mixed capacity) and information barriers. NASD also determined that the firm failed to provide documentary evidence that it performed the supervisory reviews set forth in its written supervisory procedures concerning the requirements of trade reporting (riskless principal transactions) and information barriers. **(NASD Case #CMS040128)**

**Spear, Leeds & Kellogg, L.P. (CRD #3466, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$75,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report timely to OATS Reportable Order Events (ROEs). The findings also stated that the firm submitted to OATS reports with respect to equity securities traded on the NASDAQ Stock Market that were not in the electronic form prescribed by NASD and were repairable. The reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web site. The firm did not correct or replace any of the reports, resulting in an inaccurate and/or incomplete audit trail. NASD also found that the firm failed to report timely to OATS ROEs on behalf of reporting members. **(NASD Case #CMS040136)**

**Sterling Financial Investment Group, Inc. (CRD #41506, Boca Raton, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$175,000, and required to retain, within 60 days of acceptance of the AWC, an outside consultant to review and make recommendations concerning the adequacy of the firm's current policies and procedures as they relate to the firm's research department and e-mail retention practices. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it published and distributed a research report on a biopharmaceutical company with a sell/sell short recommendation on the company's common stock that contained substantive errors and other statements that made the report exaggerated, unwarranted, or misleading. The findings

also stated that the firm failed to make disclosures required by NASD Rule 2711(h) in a clear and prominent manner. NASD also found that despite the fact the firm had potential errors in the report brought to its attention, it published a "morning note" that repeated errors in the report and failed to disclose in the note that it made a market in the securities at the time the report was published. In addition, NASD found that the firm had no effective system in place to save e-mails or other electronic messages and failed to retain e-mails for three years or for the first two years in an accessible place. Furthermore, the findings stated that although the firm's research department director had been suspended in a principal or supervisory capacity, he performed acts that were principal or supervisory in nature during his suspension. Moreover, NASD found that the firm had no system or procedures in place to ensure compliance with regulatory suspensions generally or with the director's suspension specifically. (NASD Case #CAF040064)

**Transcend Capital, LP (CRD #104483, Austin, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report ROEs timely to OATS. The findings also stated that the firm failed to submit required information to OATS. (NASD Case #CMS040133)

## Individuals Barred or Suspended

**Marvin Ackerman (CRD #1580808, Registered Representative, Long Beach, 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, Ackerman consented to the described sanction and to the entry of findings that he misused the funds of a public customer in that he accepted checks totaling \$33,845.94 from the customer for investment purposes, deposited the funds into his daughter's bank account without obtaining the products as directed, and failed to use the funds for the benefit of the customer without her knowledge or consent. The findings also stated that Ackerman provided a public customer with a fabricated account statement showing that the customer had purchased \$52,492.04 shares/units of an annuity, when such shares had never been purchased on behalf of the customer. (NASD Case #CLI040022)

**Jonnie Layne Albin (CRD #2213211, Registered Representative, Norfolk, Nebraska)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Albin consented to the described sanction and to the entry of findings that, without the knowledge or consent of the firm, she converted \$90,800 from

her member firm. (NASD Case #C04040041)

**Christopher Michael Andreach (CRD #2491323, Registered Representative, Fair Haven, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the allegations, Andreach consented to the described sanctions and to the entry of findings that he signed the names of trustees on a letter of authorization for the transfer of a 401(K) plan without the knowledge, authorization, or consent of the trustees to an IRA account.

Andreach's suspension began September 7, 2004, and concluded at the close of business October 6, 2004. (NASD Case #C9B040081)

**Robert Paul Arnold (CRD #1817656, Registered Representative, East Greenwich, Rhode Island)** 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, Arnold consented to the described sanction and to the entry of findings that he billed \$44,646 of personal expenses to his corporate credit card without the knowledge or consent of his member firm. (NASD Case #C11040032)

**Thomas Michael Curtis (CRD #2903099, Registered Representative, Marina Del Rey, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$14,412 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Curtis reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Curtis consented to the described sanctions and to the entry of findings that he recommended the purchase of Class B mutual fund shares to public customers even though each fund also offered the same mutual fund investment in Class A shares, thereby depriving the customers of discounts on sales charges that they were entitled to receive through commission breakpoints, rights of accumulation, or letters of intent. The findings also stated that the Class B shares were subject to higher annual expenses than Class A shares and were subject to penalties should the customers redeem shares within six years of the purchase. NASD also found that Curtis made recommendations without having a reasonable basis to believe that the transactions were suitable for the customers in light of the nature of the transactions and the facts disclosed by the customers regarding their other securities holdings, financial situation, and needs.

Curtis' suspension began September 20, 2004, and will conclude at the close of business October 19, 2004. (NASD Case #C02040028)

**Eric Darrisaw (CRD #1425377, Registered Principal, Alexandria, Virginia)** submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any principal capacity for five business days. Without admitting or denying the allegations, Darrisaw consented to the described sanctions and to the entry of findings that he caused his member firm to fail to maintain a continuing and current education program for its registered persons in that the firm failed to evaluate and prioritize its training needs and develop a written training plan. The findings also stated that Darrisaw caused his member firm to fail to keep accurate and current its Form BD and failed to develop and implement a written anti-money laundering program reasonably designed to achieve and monitor its compliance with the requirements of the Bank Secrecy Act and the implementation regulations promulgated thereunder by the Department of the Treasury. NASD also found that Darrisaw caused his member firm to conduct a securities business without a properly qualified and registered FINOP and to file its 2002 annual audited financial report late.

Darrisaw's suspension began October 4, 2004, and concluded at the close of business October 8, 2004. (NASD Case #C07040055)

**Eric Harold Dieffenbach (CRD #1833420, Registered Representative, Littleton, Colorado) and Michel Antoine Rooms (CRD #2187994, Registered Representative, Littleton, Colorado)** were barred from association with any NASD member in any capacity. The NAC imposed the sanctions following appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that Dieffenbach and Rooms, prior to effecting transactions in the accounts of public customers, failed to provide any of the customers with a copy of the required Risk Disclosure Document and with complete information regarding the inside bid and ask quotations, and failed to tell the customers the amount of their compensation. The findings also stated that Dieffenbach and Rooms attempted to obstruct NASD's investigation of the penny stock trading violations by contacting and bribing customers into signing non-solicitation letters, backdated and altered certain of the non-solicitation letters before submitting them to NASD, and threatened and encouraged customers to lie to NASD.

Rooms has appealed this decision to the SEC, and the sanction against Rooms is not in effect pending consideration of the appeal. (NASD Case #C06020003)

**Richard Andrew Dimare (CRD #4353581, Registered Representative, Las Vegas, Nevada)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Dimare reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification.

Without admitting or denying the allegations, Dimare consented to the described sanctions and to the entry of findings that he failed to amend his Form U4 to disclose a material fact.

Dimare's suspension began September 20, 2004, and will conclude March 19, 2005. (NASD Case #C02040030)

**John Joseph Donadio (CRD #2924386, Registered Representative, Staten Island, New York)** 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, Donadio consented to the described sanction and to the entry of findings that he, directly or indirectly, by the use of any means or instrumentalities of interstate commerce or the mails or any facility of any national securities exchange, employed artifices, devices, or schemes to defraud; made untrue statements of material fact or omitted to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices, or course of business that operated as a fraud or deceit. The findings also stated that Donadio effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive, or other fraudulent device or contrivance. Specifically, the findings stated that Donadio induced public customers to purchase 3,000 shares of stock in a company at a price of \$7.10 per share by falsely representing that the company had entered into an agreement to be acquired by another company and that the stock price would double within three to six weeks. The findings also stated Donadio failed to disclose that the company had virtually no assets or earnings and that its auditors had signed a warning in connection with the company's 2000 audit. (NASD Case #C10040064)

**James William Dreos (CRD #802681, Registered Representative, Scottsdale, Arizona)** was fined \$20,000 and suspended from association with any NASD member in any capacity for six months. The sanctions were based on findings that Dreos participated in private securities transactions for which he received compensation but failed to provide written notice to his member firm and failed to obtain written permission from his member firm to participate in the transactions.

Dreos' suspension began September 7, 2004, and will conclude March 6, 2005. (Case #C3A040017)

**Christopher Ryan Fardella (CRD #3028593, 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, Fardella consented to the described sanction and to the entry of findings that he was involved with the sale of promissory notes, the proceeds of which were to be used for the purpose of purchasing and

operating a member firm. The findings stated Fardella improperly received \$20,300 of the proceeds as loans. (NASD Case #C9B040084)

**Archie William Foor, III (CRD #1376005, Registered Representative, Yardley, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the allegations, Foor consented to the described sanctions and to the entry of findings that without the prior knowledge or authorization of public customers, he completed change of broker-dealer forms and new account forms for the customers, signed their names on the forms, and submitted the forms to his new member firm, which acted on the forms believing they were genuine.

Foor's suspension began September 20, 2004, and will conclude December 19, 2004. (NASD Case #C9A040037)

**Robert James Gallegos (CRD #3235311, Registered Representative, Albuquerque, New Mexico)** submitted a Letter of Acceptance, Waiver, and Consent in which he was ordered to pay \$14,000, plus interest, in restitution to a public customer and barred from association with any NASD member in any capacity. The restitution must be paid before Gallegos requests relief from any statutory disqualification. Without admitting or denying the allegations, Gallegos consented to the described sanctions and to the entry of findings that he obtained the control of, and held in his possession, \$22,500 belonging to a public customer, which he later returned to the customer. The findings also stated that Gallegos obtained and used for his own benefit \$14,000 belonging to a public customer, and that Gallegos failed to respond to NASD requests for information. (NASD Case #C3A040037)

**Rodney Kim Hartman (CRD #1339855, Registered Representative, St. George, Utah)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. The fine must be paid before Hartman reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hartman consented to the described sanctions and to the entry of findings that he exercised discretion in the account of a public customer without written authorization from the customer and without obtaining his firm's written acceptance of the account as discretionary.

Hartman's suspension began September 20, 2004, and concluded at the close of business October 1, 2004. (NASD Case #C3A040039)

**John Arthur Isham (CRD #2213222, Registered Representative, Garner, North Carolina)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Isham consented to the described sanction and to the entry of findings that he forged the signatures of public customers on "Amendment of Application and Statement of Health" forms. (NASD Case #C07040068)

**Thomas Michael Keating, Jr. (CRD #736904, Registered Representative, Glendale, Wisconsin)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Keating consented to the described sanctions and to the entry of findings that he engaged in outside business activity, for compensation, and failed to provide his member firm with prompt written notice.

Keating's suspension began October 4, 2004, and concluded at the close of business October 15, 2004. (NASD Case #C8A040076)

**Daniel Eric Kelsey (CRD #3031423, Registered Representative, Grand Rapids, Michigan)** was fined \$14,500, suspended from association with any NASD member in any capacity for 60 days, and ordered to requalify by exam as an investment company variable products representative within 60 days of the termination of his suspension. The fine shall become due and payable upon Kelsey's re-entry into the securities business. The sanctions were based on findings that Kelsey made material misrepresentations or omissions to public customers regarding his personal history and the concept of variable life insurance to induce their purchase of variable universal life insurance policies. The findings also stated that Kelsey made negligent misrepresentations to public customers concerning the required premium payments and the withdrawal or deposit of funds to variable life insurance policies. NASD also found that Kelsey failed to timely update his Form U4, filed a false Form U4, and willfully failed to disclose material information on his Form U4.

Kelsey's suspension began August 16, 2004, and concluded at the close of business October 14, 2004. (NASD Case #C8A020088)

**Mohit Anand Khanna (CRD #4156626, Registered Representative, San Diego, California)** submitted a Letter of Acceptance, Waiver, and Consent in which Khanna was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Khanna consented to the described sanction and to the entry of findings that he falsely represented to public customers, without his member firm's knowledge or consent, that his firm would refund sales

charges when mutual fund shares were sold after the customers had purchased approximately \$1.4 million of mutual fund Class A shares. The findings also stated that after Khanna made these false representations, the customers purchased approximately \$400,000 of additional Class A shares in their accounts. (NASD Case #C02040026)

**Dana Alexander Korosi (CRD #816161, Registered Representative, Moreland Hills, Ohio)** 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, Korosi consented to the described sanction and to the entry of findings that he converted \$188,398 from the securities account of a public customer by writing 60 checks made payable to himself, endorsed the checks and used the proceeds for his own benefit, or for the benefit of someone other than the customer, without the customer's knowledge, consent, or authorization. The findings also stated that Korosi failed to respond to NASD requests for information. (NASD Case #C8A040017)

**Craig Poy Lee (CRD #2680766, Registered Representative, South Elgin, Illinois)** submitted an Offer of Settlement in which he was barred from association with any NASD member firm any capacity. Without admitting or denying the allegations, Lee consented to the described sanction and to the entry of findings that he participated in private securities transactions, and failed to provide written notice to, or receive approval from, his member firm to participate in these activities. The findings also stated that Lee failed to respond to NASD requests for information. (NASD Case #C8A040065)

**Michael Douglas Lutey (CRD #4718604, Associated Person, Houston, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,500 and suspended from association with any NASD member in any capacity for 45 days. The fine must be paid before Lutey reassociates with a member firm following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Lutey consented to the described sanctions and to the entry of findings that he failed to disclose material facts on his Form U4.

Lutey's suspension began September 20, 2004, and will conclude at the close of business November 3, 2004. (NASD Case #C06040028)

**Steven Paul Mednick (CRD #1386095, Registered Representative, East Northport, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$9,500, ordered to disgorge \$1,418, plus interest, in partial restitution to a public customer, and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations,

Mednick consented to the described sanctions and to the entry of findings that he recommended that public customers purchase municipal bonds primarily based on statements by his member firm and failed to perform his own independent research or investigation relating to the bonds. The findings also stated that Mednick did not have reasonable grounds for believing that his recommendations and resultant transactions were suitable for the financial situation, investment objectives, and needs of the customers.

Mednick's suspension began September 20, 2004, and concluded at the close of business October 1, 2004. (NASD Case #C10040093)

**Philip David Menard (CRD #1796404, Registered Representative, Germantown, Tennessee)** 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, Menard consented to the described sanction and to the entry of findings that he signed names of public customers to applications for variable annuities without the customers' knowledge or consent. The findings also stated that Menard then submitted each application to his member firm for approval and issuance by the insurance company. (NASD Case #C02040024)

**James Gary Morgan, Jr. (CRD #2976626, Registered Representative, Denton, Texas)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and required to pay \$29,000, plus interest, in restitution to public customers. Without admitting or denying the allegations, Morgan consented to the described sanctions and to the entry of findings that he fraudulently sold unsuitable securities to a public customer. The findings also stated that Morgan lied to NASD under oath during on-the-record testimony, and that he failed to amend his Form U4 to disclose material information. (NASD Case #CMS040048)

**Bernard Edward Nugent, Jr. (CRD #1209387, Registered Principal, Yarmouthport, Massachusetts)** 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 two months. Without admitting or denying the allegations, Nugent consented to the described sanctions and to the entry of findings that he recommended that a public customer liquidate approximately \$317,000 in mutual fund shares and purchase a variable annuity without having a reasonable basis for believing that the recommendation was suitable based on his client's investment objectives, financial situation, and needs.

Nugent's suspension began October 4, 2004, and will conclude at the close of business December 3, 2004. (NASD Case #C11040031)

**Daniel John O'Brien (CRD #1919816, Registered Representative, Missouri City, Texas)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, O'Brien consented to the described sanctions and to the entry of findings that he engaged in outside business activities by receiving \$46,447 in compensation for selling fixed annuities to public customers. The findings also stated that O'Brien failed and neglected to give prompt written notice of these activities to his member firm.

O'Brien's suspension began September 20, 2004, and concluded at the close of business October 1, 2004. **(NASD Case #C8A040073)**

**Carlos Julio Penalzoza (CRD #2187279, Registered Principal, Coral Gables, Florida)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500, and suspended from association with any NASD member in a principal capacity for 30 business days. Without admitting or denying the allegations, Penalzoza consented to the described sanctions and to the entry of findings that he permitted another individual of his member firm to act in the capacity of a general securities representative by effecting securities transactions without being registered as a general securities representative and to act in the capacity of a general securities principal by acting as a branch manager without being registered as a general securities principal.

Penalzoza's suspension began September 20, 2004, and will conclude at the close of business October 29, 2004. **(NASD Case #C10040091)**

**Michael A. Quinones (CRD #3027561, Associated Person, Brooklyn, New York)** was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Quinones consented to the described sanction and to the entry of findings that he willfully failed to disclose material information on his Form U4 and failed to respond to NASD requests for information. **(NASD Case #C10030113)**

**Christopher Michael Reno (CRD #2128187, Registered Representative, Staten Island, New York)** was barred from association with any member in any capacity. The sanction was based on findings that Reno failed to respond to NASD requests for information. The findings also stated that Reno engaged in unauthorized purchase transactions in the accounts of public customers without prior authorization or consent of the customers. **(NASD Case #C9B040004)**

**Ileana Rodriguez (CRD #2834408, Registered Representative, Miami, Florida)** 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, Rodriguez consented to the described sanction and to the entry of findings that she misrepresented material information to a public customer in a written investment proposal. The findings also stated that Rodriguez failed to respond to NASD requests for information. **(NASD Case #C07040070)**

**Charles Anthony Sacco (CRD #2762595, Registered Representative, Medford, Massachusetts)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for one year. In light of the financial status of Sacco, no monetary sanction has been imposed. Without admitting or denying the allegations, Sacco consented to the described sanctions and to the entry of findings that he maintained relationships with certain clients, including hedge funds, that engaged in the "market timing" of mutual funds. The findings also stated that Sacco established a number of accounts for each of his market-timing customers and obtained various consultant numbers from his member firm to maximize for each customer the number of exchanges permitted by the mutual fund complexes before the customers' trading was blocked by the mutual fund complexes. NASD also found that Sacco established another financial consultant number using his and another person's initials to resume trading at a particular mutual fund complex and avoid restrictions placed on his trading activities.

Sacco's suspension began September 20, 2004, and will conclude at the close of business September 19, 2005. **(NASD Case #C11040033)**

**Lucas Charles Schell (CRD #4290983, Registered Representative, Coeur d'Alene, Idaho)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Schell reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Schell consented to the described sanctions and to the entry of findings that he affixed the signature of a public customer to an Application for Policy Change/Reinstatement directed to an insurance company to reinstate the customer's life insurance policy without the authorization or consent of the customer.

Schell's suspension began September 20, 2004, and will conclude March 19, 2005. **(NASD Case #C3B040023)**

**Edward Lee Sensor (CRD #1969463, Registered Principal, Sterling Illinois)** was barred from association with any NASD member firm in any capacity. The sanction was based on findings that Sensor failed to respond to NASD requests for information. The findings also stated that Sensor engaged in private securities transactions without giving prior written notice to, or obtaining prior written approval from, his member firm.

NASD also found that Sensor engaged in an outside business activity without providing prompt written notice to his member firm. (NASD Case #C8A040010)

**Wayne Davis Shook (CRD #2837213, Registered Representative, Old Orchard Beach, Maine)** submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for one year. In light of the financial status of Shook, no monetary sanction was imposed. Without admitting or denying the allegations, Shook consented to the described sanction and to the entry of findings that he executed transactions in the account of a public customer without reasonable grounds for believing that the level of activity represented by such transactions was suitable for the customer on the basis of her financial condition, investment, objectives, and needs. The findings also stated that Shook exercised effective control over the customer's account, engaging in trading activity that was excessive in size and frequency, trading on margin in the customer's account, and effecting purchases in the account costing approximately \$191,178 that corresponded to an annualized turnover rate of approximately 12 times.

Shook's suspension began September 20, 2004, and will conclude at the close of business September 19, 2005. (NASD Case #C8A040047)

**Rick Christopher Siskey (CRD #1463173, Registered Representative, Charlotte, North Carolina)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Siskey reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Siskey consented to the described sanctions and to the entry of findings that he engaged in private securities transactions and failed to provide sufficient prior written notice to his member firm.

Siskey's suspension began September 20, 2004, and will conclude at the close of business September 19, 2006. (NASD Case #C07040075)

**Leon Harry Strohecker, III (CRD #2829676, Registered Representative, Whitmore Lake, 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, Strohecker consented to the described sanction and to the entry of findings that he willfully failed to disclose a material fact on his Form U4. (NASD Case #C9A040036)

**Jan Miguel Tapia (CRD #1047359, Registered Principal, Staten Island, New York)** 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, Tapia consented to the described sanction and to the entry of findings that he received a \$100,000 check from a public customer for investment purposes and did not deposit or apply the funds as instructed. NASD also found that Tapia wired, or caused to be wired, \$98,128.08 from a public customer's securities account to accounts in which Tapia and/or his wife had beneficial interest using false letters of authorization to effect the transfers without the knowledge, authorization, or consent of the customer. The findings also stated that Tapia failed to respond to NASD requests for information. (NASD Case #C10040047)

**Stephen Nicholas Thomas (CRD #3236045, Registered Representative, Queens, New York)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Thomas made improper use of public customer funds. (NASD Case #C10030082)

**Ronald James Turner (CRD #2735639, 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, Turner consented to the described sanction and to the entry of findings that he made improper use of proceeds from the sale of promissory notes. The findings also stated that Turner failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #C9B040083)

**Brian Michael Uhelski (CRD #2807010, Registered Principal, Mason, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Uhelski consented to the described sanction and to the entry of findings that he participated in outside business activities without providing prompt written notice to his member firm. (NASD Case #C8A040077)

**Karen Taxacher Wardlaw (CRD #800300, Registered Representative, Plantation, Florida)** 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, Wardlaw consented to the described sanction and to the entry of findings that she failed to respond to an NASD request for information. (NASD Case #C07040076)

**Ronald Dean Wightman (CRD #466601, Registered Principal, Salt Lake City, Utah)** submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any supervisory capacity

for 30 days. Without admitting or denying the allegations, Wightman consented to the described sanctions and to the entry of findings that he failed to supervise a registered representative in a manner reasonably designed to achieve compliance with Rule 3040.

Wightman's suspension began October 4, 2004, and will conclude at the close of business November 2, 2004. (NASD Case #C02040016)

## Decisions Issued

The District Business Conduct Committee (DBCC) or the OHO have issued the following and have been appealed to or called for review by the NAC as of September 3, 2004. 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*.

**Herbert Ivan Kay (CRD #1374570, Registered Principal, Tucson, Arizona)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Kay participated in private securities transactions without prior written notice to, or approval from, his member firm to participate in the transactions.

This decision has been appealed to the NAC, and the sanction is not in effect pending consideration of the review. (NASD Case #C3A030015)

**Richard Leon Newberg (CRD #346857, Registered Principal, Golden Beach, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Newberg provided false testimony during an NASD hearing.

This decision has been appealed to the NAC, and the sanction is not in effect pending consideration of the appeal. (NASD Case #CAF030013)

**Andrew Paul Schneider (CRD #2907279, Registered Representative, West Palm Beach, Florida)** was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. The sanctions were based on findings that Schneider engaged in outside business activity without providing his member firm with prompt written notice.

This decision has been appealed by the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #C10030088)

## Complaints Filed

NASD issued the following complaints. 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.

**Dana Niles Frankfort (CRD #2243930, Registered Representative, Marina Del Rey, California)** was named as a respondent in an NASD complaint alleging that he instructed an individual to authorize and pay the full amount of a limited partner's initial investment in a limited partnership without regard to the net profit or loss or the relative value of the partner's account, resulting in the account being reduced to a \$0 balance and constituting a re-purchase by the limited partnership of the individual's partnership interest in contravention of the representations in the private placement memorandum. The complaint also alleges that this payment caused the remaining limited partners to suffer losses in the value of their interests unrelated to market returns, and Frankfort failed to notify the other partners that the partnership had re-purchased the interest of the one individual and that the partnership had suffered significant market losses since its inception.

In addition, the complaint alleges that Frankfort, in connection with the sale of limited partnership interests and with the purchase of one customer's limited partnership interest, with scienter, directly or indirectly, by the use of 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 true, in light of the circumstances under which they were made, not misleading; and engaged in acts, practices, or courses of business that operated or would operate as a fraud or deceit upon purchasers or prospective purchasers. Furthermore, the complaint alleges that Frankfort made recommendations to public customers to purchase limited partnership interests without a reasonable basis and failed to conduct due diligence prior to making the recommendations. Moreover, the complaint alleges that Frankfort made the recommendations when he knew, or should have known, that the fund manager had no prior experience in managing investment funds for the benefit of public customers and made the recommendations without having reasonable grounds for believing the recommendations and resultant transactions were suitable for the customers on the basis of their financial situation and needs. The complaint also alleges that Frankfort participated in private securities transactions without prior written notification to, and written approval from, his member firm. (NASD Case #C02040032)

Dupont Securities Group, Inc. (CRD #42305, New York, New York) and David Wayne Parsons (CRD #2963654, Registered Principal, New York, New York) were named as respondents in an NASD complaint alleging that the firm and Parsons engaged in unlawful sales of unregistered shares of a common stock of the publicly traded parent company of the firm because there was no registration statement filed or in effect pursuant to Section 5 of the Securities Act of 1933. The complaint also alleges that the firm issued press releases that were materially false and misleading and Parsons knew or was reckless in not knowing that the press releases and other communications were false and misleading but allowed the information to be disseminated to the public. In addition, the complaint alleges that the issuance of the false and misleading press releases and other conduct by the firm were intended to, and did, artificially inflate the price of the common stock, thereby defrauding investors. Furthermore, the complaint alleges that Parsons willfully misrepresented on his Form U4 that his authorization to act as an attorney had never been revoked or suspended when, in fact, it had been and provided legal advice with respect to securities transactions when he was not licensed to practice law. Moreover, the complaint alleges that during sworn testimony, Parsons refused to answer questions based on assertions of attorney-client privilege that were false because he could not lawfully assert such a privilege as he was not licensed to practice law in any state. (NASD Case #CAF040068)

Samuel Davis Hughes (CRD #1928041, Registered Representative, Panama City, Florida) was named as a respondent in an NASD complaint alleging that he recommended and effected transactions in the accounts of public customers without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customers based on the customers' financial situations, investment objectives, and needs. In addition, the complaint alleges that Hughes failed to disclose to a customer that surrender charges would be assessed for sales and misrepresented that a customer would receive a bonus payment for annuity purchases. The complaint also alleges that Hughes reallocated a public customer's funds without their knowledge or authorization and failed to respond to NASD requests to appear for testimony. (NASD Case #C07040067)

Jayne Alexander Kurtyka (CRD #1171623, Registered Representative, W. Chicago, Illinois) was named as a respondent in an NASD complaint alleging that he recommended and effected securities transactions in the account of a public customer, including purchasing securities on margin, without having a reasonable basis for believing that the recommendations and resultant transactions were suitable for the customer based upon the customer's age, total net worth, liquid net worth, investment experience, financial situation, and investment objectives. The complaint also alleges that Kurtyka exercised discretion in the account of a public customer without

obtaining written authorization from the customer and written acceptance of the account as discretionary by his member firm. In addition, the complaint alleges that Kurtyka prepared and mailed, or caused to be prepared and mailed, a form letter considered by NASD to be sales literature that was not fair and balanced and omitted material facts or qualification, causing the form letter to be misleading or containing exaggerated, unwarranted, or misleading statements or claims. The complaint further alleges that the form letter failed to provide a fair and balanced presentation in that it failed to disclose the material differences between the general nature of the fund's portfolio and securities indexes against which it was compared. (NASD Case #CAF040067)

Sterling Scott Lee (CRD #1848950, Registered Principal, Austin, Texas) and Dennis Todd Lloyd Gordon (CRD #1614614, Registered Principal, Houston, Texas) were named as respondents in an NASD complaint alleging that they permitted an individual to function as an unregistered principal of a member firm for over three years. The complaint also alleges that Lee and Gordon knew, or should have known, that the individual was not registered in any capacity. The complaint further alleges that Lee and Gordon, acting on behalf of their member firm, charged its customers prices for an equity security that were not fair and reasonable based on all relevant circumstances, including market conditions with respect to such security at the time of the transactions, the expenses involved, and the fact that his firm was entitled to a profit. They also failed to disclose the mark-ups on customer confirmation statements. (NASD Case #C06040027)

Rick Lee Matney (CRD #1828590, Registered Representative, Marshalltown, Iowa) was named as a respondent in an NASD complaint alleging that Matney received a check totaling \$2,018.80 from a public customer to cover property and casualty insurance on certain properties. The complaint alleges that Matney discovered that his insurance company would not underwrite the insurance that Matney had verbally committed to in his conversation with the customer, did not relay this information to the customer, and applied the \$2,018.80 check to premiums for existing insurance policies held by the customer. The complaint also alleges that the customer requested details on the property and casualty insurance that she had purchased through Matney, including the cost and coverage amounts of each policy, and Matney created insurance declarations pages for property and casualty insurance purportedly underwritten by his insurance company. However, the property and casualty insurance reflected in the declarations pages was not underwritten by his insurance company. In addition, the complaint alleges that Matney fabricated this information to satisfy the customer's request. (NASD Case #C04040036)

Anthony Stephen McComas (CRD #708707, Registered Representative, Guaynabo, Puerto Rico) was named as a respondent in an NASD complaint alleging that he caused \$466,827 in checks to be issued from a public customer's securities account, which he deposited into a bank account that he controlled without the knowledge or authorization of the customer. The complaint also alleges that McComas failed to respond to NASD requests for information. (NASD Case #C07040072)

Jamie Patrick McNamara (CRD #4546647, Registered Representative, Lees Summit, Missouri) was named as a respondent in an NASD complaint alleging that he received a \$388 money order from a public customer payable to his member firm to obtain automobile insurance coverage. The complaint alleges that McNamara deposited the funds into a personal d/b/a account and did not purchase the automobile insurance coverage for the customer as requested. The complaint also alleges that the customer requested details on the automobile coverage that she had requested and believed she had purchased, and McNamara created a fictitious automobile insurance card and provided it to the customer. In addition, the complaint alleges that McNamara failed to respond to NASD requests for information. (NASD Case #C04040040)

Nicholas Harrel Patton, Jr. (CRD #1545508, Registered Supervisor, Little Rock, Arizona) was named as a respondent in an NASD complaint alleging that Patton received checks totaling \$27,214.25 from public customers to invest in securities. The complaint alleges that Patton failed and neglected to remit these funds to his member firm, and, instead, deposited the checks into his personal bank checking account without the customers' knowledge or consent, thereby converting the customers' funds. The complaint also alleges that Patton failed to respond to NASD requests for information. (NASD Case #C05040063)

Rick James Settles (CRD #1559298, Registered Principal, Louisville, Kentucky) was named as a respondent in an NASD complaint alleging that Settles recommended and effected purchase and sales transactions in the accounts of public customers without having reasonable grounds for believing that the recommendations and resultant transactions were suitable for the customers on the basis of their financial situations and needs. The complaint also alleges that Settles exercised discretionary authority in the accounts of public customers without having obtained prior written acceptance of the accounts as discretionary by his member firm. (NASD Case #C05040062)

## **Firms Suspended for Failure to Supply Financial Information**

The following firms were suspended from membership in NASD for failure to comply with formal written requests to submit financial information to NASD. The action was based on the provisions of NASD Rule 9552. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

**Coastal Financial Security, Incorporated**  
Orangeburg, New York  
(September 7, 2004)

**ICG Securities Ltd.**  
San Francisco, California  
(September 7, 2004)

**Investment Researched Plans, Inc.**  
Los Angeles, California  
(September 7, 2004)

**Joseph Wrobel**  
Las Vegas, Nevada  
(September 7, 2004)

**WM B. Austin & Associates**  
Moulins, France  
(September 7, 2004)

## **Firms Suspended Pursuant to NASD Rule 9553 for Failure to Pay Fees Resulting from Arbitration Proceedings**

**Barry Murphy & Company, Inc.**  
Boston, Massachusetts  
(September 15, 2004)

**Chapman Securities, Inc.**  
Wichita, Kansas  
(August 30, 2004)

**Hanmi Securities, Inc.**  
Los Angeles, California  
(September 15, 2004)

**Individuals Barred Pursuant to NASD Rule 9552 for Failure to Provide Information Requested Under NASD Rule 8210**

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

**Clancy, William James**  
Rahway, New Jersey  
(September 13, 2004)

**Dhillon, Hardip S.**  
Fremont, California  
(September 13, 2004)

**Flor, Gary J.**  
Huntington, New York  
(September 14, 2004)

**Gardner, Walter R.**  
Little Rock, Arkansas  
(September 8, 2004)

**Hsieh, Tu-Chih**  
Ridgefield, New Jersey  
(September 14, 2004)

**Jacks, Gary M.**  
Maineville, Ohio  
(September 9, 2004)

**Leonardi, Carl D.**  
Rochester, New York  
(August 23, 2004)

**Individuals Suspended Pursuant to NASD Rule 9552 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.)

**Hollander, Richard S.**  
Boca Raton, Florida  
(August 23, 2004)

**Pope, Michael**  
Pittsburgh, Pennsylvania  
(August 23, 2004)

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

**Head, Thomas M.**  
Palm Desert, California  
(September 15, 2004)

**Weaver, Kevin M.**  
Edwards, Colorado  
(August 3, 2004)

**NASD Fines Sentinel Financial Services \$700,000 for Failing to Prevent Market Timing**

*Supervisory Inadequacies Cited; Over \$650,000 in Restitution Paid to Affected Funds*

NASD censured and fined Sentinel Financial Services Company, of Montpelier, Vermont, \$700,000 for failing to prevent market timing in three mutual funds offered by its affiliate, Sentinel Group Funds, Inc. Sentinel also failed to establish and maintain a reasonable supervisory system designed to detect and prevent market timing in violation of the funds' trading policies.

"As the distributor for a family of mutual funds, Sentinel was uniquely situated to enforce prospectus limits and fund policies designed to limit market timing, which can dilute the value of fund shares, raise transaction costs and thus harm other fund shareholders," said NASD Vice Chairman Mary L. Schapiro. "But the absence of effective supervisory systems enabled certain shareholders to engage in impermissible market timing for years."

After NASD completed its investigation, Sentinel paid \$659,674 in restitution to the three affected funds—Sentinel International Equity Fund (\$645,631), Sentinel Bond Fund (\$10,098) and Sentinel High Yield Bond Fund (\$3,945).

NASD found that despite Sentinel's adoption of an "Excessive Trading Policy" in October 2000—specifically designed to monitor and restrict market timing—Sentinel's inadequate supervisory system enabled some customers of broker-dealers to continue to trade shares of Sentinel mutual funds more frequently than the policy and fund prospectuses allowed.

Sentinel's supervisory procedures and systems were not sufficient to detect and prevent market timing and excessive mutual fund exchanges, and lacked sufficient checks and balances. Sentinel left primary review of the firm's excessive trading surveillance data and reports to its wholesalers and non-compliance personnel, and relied on those individuals to monitor and prevent excessive trading in the funds.

NASD's investigation, which covered the period from October 2000 to October 2003, found that Sentinel could only detect market timing after customers had already engaged in excessive transactions. Even after Sentinel restricted their accounts, some customers were able to establish new accounts and continue trading in Sentinel mutual funds. Sentinel also did not have an effective system to monitor fund exchange activity by accounts under common ownership.

NASD also found that prior to adopting its Excessive Trading Policy in October 2000, Sentinel had entered into understandings with two brokers permitting them to engage in limited market timing of Sentinel funds. Sentinel not only allowed the two brokers to continue their market timing activities after the new policy was adopted, but was unable to enforce the trading limitations spelled out in those understandings.

During its investigation, NASD also found that Sentinel failed to maintain and preserve internal e-mail communications relating to the firm's business as required by the federal securities laws and NASD rules. For example, the firm failed to retain all e-mails that were deleted by its registered employees.

In addition to fining the firm and requiring restitution, NASD required Sentinel to certify that it has disclosed all instances of fund trading that was inconsistent with the fund prospectuses and Sentinel's Excessive Trading Policy, and that it has implemented appropriate systems and controls with respect to market timing.

In settling this matter, Sentinel neither admitted nor denied the charges.

### **NASD Charges David Lerner Associates with Using Misleading Radio Spots, Investment Seminars, Other Ads**

#### ***Firm President David Lerner, Senior VP, and Affiliated Firm also Charged***

NASD charged David Lerner Associates, Inc., of Syosset, New York and its president, David Lerner, with violating NASD advertising rules through its advertising, investment seminars, and other communications with the public. Also charged were John Dempsey, the firm's Senior Vice President of Sales, and SSH Securities, Inc., an affiliate of David Lerner Associates that is controlled by David Lerner.

According to the complaint, between May 2001 and May 2003, David Lerner and the firm used radio advertisements, investment seminars, and other communications that contained numerous statements and claims that were misleading, exaggerated, or unwarranted.

The firm advertised heavily on New York metropolitan area radio stations with 60-second spots that ran several days a week, frequently throughout the day. The firm's expenditures on advertising and marketing were equivalent to 17 percent of its total 2002 total revenue of \$12 million, with the vast majority of the expenditures going to radio advertisements. Lerner developed the ideas for the radio advertisements and narrated all of the radio spots as the "voice" of the firm. A recurring theme of the ads was the concept of "providing returns of 10 percent and more" to "tens of thousands" of customers. Among the claims made in the radio ads:

"For 25 years, we at David Lerner Associates have provided tens of thousands of people with investments that even in these turbulent times, continue to pay over 10%."

"We are currently providing returns of 10% and more in investments that have nothing to do with the stock market."

"In spite of the gyrations of the stock market, our clients continue to enjoy high dividend returns - in many cases 10% and more."

NASD charged that these statements, which the firm could not support, were exaggerated, unwarranted, or misleading. In addition, some ads contained stories about individuals Lerner allegedly had met, suggesting the person's investments would have performed better had the person invested with the firm or followed the firm's investment philosophy. The firm, however, could not provide support that the incidents described actually occurred.

"Exaggerated and misleading claims of investment returns violate NASD rules designed to protect the public," said NASD Vice Chairman Mary L. Schapiro. "In this case, the firm's unjustified suggestion of consistent 10 percent investment returns over a period of years, together with its use of statements designed to appear as customer testimonials, is misleading and an abuse of the investing public."

The firm's advertisements also suggested that individuals who invested with David Lerner Associates would retain the value of their assets regardless of market conditions, or would regain prior losses sustained in the stock market. For instance, the advertisements stated:

"While past performance can never be a guarantee of future results, we at David Lerner Associates are proud and pleased that for 26 years, tens of thousands of our investors have been receiving high income and solid returns regardless of whether interest rates or the stock market went up or down."

"As a result of our conservative investment philosophy, tens of thousands of investors have been spared the agony of the financial markets, and every day new investors are coming to David Lerner Associates to repair the damage."

NASD charged that these statements were also exaggerated or misleading and improperly implied guarantees.

Investment seminars were also important to the firm's marketing efforts. During the relevant period, the firm conducted approximately 70 to 80 seminars for the public, with Lerner appearing as the principal speaker at each seminar. Lerner's PowerPoint presentations contained statements and claims similar to those made in the radio advertisements. As with the radio ads, the firm did not have factual support for many of the claims and also omitted to disclose important information.

Finally, SSH Securities prepared, and David Lerner Associates distributed, fact sheets concerning Spirit of America mutual funds that NASD charged contained inaccurate information. Specifically, the fact sheets' listings of the top ten holdings of the Spirit of America funds were inaccurate at the time the sheets were distributed. In addition, the material compared the funds' performance with that of the S&P 500 and the Dow Jones Industrials without explaining the many differences between the Spirit of America funds, which were comprised of publicly traded real estate investment trusts (REITs), and those broad stock market indices.

NASD also charged Dempsey, the principal of David Lerner Associates responsible for approving advertisements, with failing to discharge his supervisory responsibilities. Dempsey violated NASD rules by approving the misleading radio ads as well as by failing to review and approve the other advertising cited in the NASD's complaint.

Under NASD rules, the respondents named in the complaint can file a response and request a hearing before an NASD disciplinary panel. Possible sanctions include a fine, suspension, bar, or expulsion from NASD.

### **NASD Hearing Panel Dismisses Complaint against Win Capital, Two Officers**

An NASD Hearing Panel dismissed a June 2003 complaint charging Win Capital Corp. of Long Island, NY and two of its officers with securities fraud in connection with a hedge fund offering.

NASD's Enforcement Department had charged Win Capital, acting through then-Chairman Steven J. Bayern and then-President Patrick M. Kolenick, with failing to disclose certain material facts to investors in a hedge fund the two men had formed. They raised approximately \$1 million by selling limited partnership interests in the hedge fund to 12 investors.

At issue in the hearing was Bayern's and Kolenik's failure to disclose to those investors that of the approximately \$1 million raised, \$700,000 was used to provide a loan to a business colleague. The hearing panel concluded that NASD Enforcement had failed to prove that the disclosure omissions were material.

The panel also found no evidence that the respondents intended to deceive investors.

### **NASD Sanctions 18 Firms for OATS Reporting and Supervision Violations**

#### ***Total Fines Over \$1.2 Million; SG Cowen Ordered to Pay \$800,000***

NASD censured and imposed fines totaling more than \$1.2 million on 18 firms for violations relating to NASD's OATS rules and supervision. The largest single action was against SG Cowen, LLC of New York, NY, which was censured and fined \$800,000 for failing to report millions of orders over a four-year period.

"The enforcement actions announced today are against a wide range of firms for violations such as missing reports, inaccurate data, and failure to correct data after it had been rejected," said NASD Vice Chairman Mary L. Schapiro. "These actions are part of NASD's ongoing efforts to ensure that the audit trail is complete and accurate. The information reported to OATS enables NASD to recreate the life cycle of an order, substantially enhancing the NASDAQ audit trail and ensuring NASD's ability to conduct effective market surveillance."

Compliance with OATS rules is critical to NASD's regulation of The Nasdaq Stock Market, Inc. Firms are required by OATS rules to report specific data elements related to the handling and execution of customer orders and certain proprietary orders for NASDAQ securities, and to synchronize their business clocks as required by NASD.

Regarding SG Cowen, NASD found that the firm failed to report OATS data for approximately 50 million orders received by the firm's equity derivatives desk between October 1999 and March 2004. The firm developed a system for capturing and reporting OATS data for its equity derivatives desk in 1999. But after operational changes to that system were implemented shortly after the firm began OATS reporting, data generated for the equity derivatives desk was never forwarded to NASD, even though other trading desks at the firm were regularly submitting voluminous OATS reports.

Because Cowen did not have an adequate supervisory system, the firm did not discover the problem until late 2003—four years later. Once it did discover the problem, the firm investigated its source and scope, and reported its findings to NASD in May 2004. The fine against Cowen consists of \$500,000 for inadequate supervision and \$300,000 for OATS violations. The sanctions against Cowen reflect the extensive failure to report OATS data, the inadequate supervision, the firm's significant disciplinary history, and a substantial credit for investigating the matter and bringing it to NASD's attention.

The fines imposed total \$1,219,000 and involve the following firms:

- ▶ **Spear, Leeds & Kellogg, L.P.** – censure and a \$75,000 fine for late OATS reporting on its own behalf and on behalf of reporting members, and failing to correct or replace rejected OATS reports on its own behalf and on behalf of reporting members.
- ▶ **Schwab Capital Markets, L.P.** – censure and a \$70,000 fine for failing to correct or replace rejected OATS reports, submitting inaccurate OATS data, and supervisory deficiencies concerning OATS compliance.
- ▶ **Credit Suisse First Boston, L.L.C.** – censure and a \$50,000 fine for late OATS reporting, failing to correct or replace rejected OATS reports, and submitting inaccurate OATS data.
- ▶ **Carlin Equities Corporation** – censure and a \$35,000 fine for late OATS reporting, failing to correct or replace rejected OATS reports, submitting inaccurate and/or incomplete OATS data, and supervisory deficiencies concerning OATS compliance.
- ▶ **FutureTrade Securities, L.L.C.** – censure and a \$35,000 fine for failing to correct or replace rejected OATS reports, submitting inaccurate OATS data and supervisory deficiencies concerning OATS compliance.
- ▶ **Pulse Trading, Inc.** – censure and a \$20,000 fine for failing to submit required OATS data, late OATS reporting, and supervisory deficiencies concerning OATS compliance.
- ▶ **Scottrade, Inc.** – censure and a \$16,000 fine for failing to correct or replace rejected OATS reports and supervisory deficiencies concerning OATS compliance.
- ▶ **Delta Asset Management Company, L.L.C.** – censure and a \$15,000 fine for failing to submit required OATS data, late OATS reporting and supervisory deficiencies concerning OATS compliance.
- ▶ **Deutsche Bank Securities, Inc.** – censure and a \$15,000 fine for late OATS reporting and supervisory deficiencies concerning OATS compliance.
- ▶ **Doyle, Miles & Co., L.L.C.** – censure and a \$12,500 fine for late OATS reporting and supervisory deficiencies concerning OATS compliance.
- ▶ **Quantlab Securities, L.P.** – censure and a \$12,500 fine for failing to report OATS data and supervisory deficiencies concerning OATS compliance.
- ▶ **BNY Brokerage, Inc.** – censure and a \$12,000 fine for failing to correct or replace rejected OATS reports and supervisory deficiencies concerning OATS compliance.
- ▶ **Index Securities, LLC** – censure and an \$11,000 fine for failing to correct or replace rejected OATS reports and supervisory deficiencies concerning OATS compliance.
- ▶ **Mid-Atlantic Capital Corporation** – censure and a \$10,000 fine for late OATS reporting and supervisory deficiencies concerning OATS compliance.
- ▶ **Options Trading Associates, LLC** – censure and a \$10,000 fine for improperly formatted OATS data and supervisory deficiencies concerning OATS compliance.
- ▶ **Transcend Capital, LP** – censure and a \$10,000 fine for late OATS reporting and failing to submit required OATS data.
- ▶ **UBS Securities, L.L.C.** – censure and a \$10,000 fine for submitting inaccurate and/or incomplete OATS data.

In including these settlements, the firms neither admitted nor denied the charges.

### **Deutsche Bank Securities Inc. and Thomas Weisel Partners LLC Settle Enforcement Actions Involving Conflicts of Interest between Research and Investment Banking**

*Deutsche Bank Securities to Pay \$87.5 Million, Including Penalty of \$7.5 Million for Failing to Timely Produce All E-mail; Thomas Weisel Partners to Pay \$12.5 Million*

The Securities and Exchange Commission, the North American Securities Administrators Association (NASAA), NASD, Inc., New York Stock Exchange (NYSE), and state securities regulators, including California's Department of Corporations, announced enforcement actions against Deutsche Bank Securities Inc. and Thomas Weisel Partners LLC. These settlements are related to the April 2003 Global Settlement that ten other investment banks reached with the SEC, state securities regulators, NASD, and NYSE following investigations of allegations that investment banking interests had undue influence on securities research at brokerage firms. The enforcement actions against Deutsche Bank Securities and Thomas Weisel Partners, together with the Global Settlement announced last year, are part of a comprehensive

regulatory effort to reform the relationship between investment banking and research and to improve industry practices relating to fundamental research.

### ***Terms of the Settlement: Penalties, Disgorgement, Funds for Independent Research and Investor Education, Reforms, and Injunctions***

Deutsche Bank Securities will pay a total of \$87.5 million: \$25 million in disgorgement, \$25 million as a penalty for various conflicts of interest, \$25 million to fund independent research, \$5 million to fund and promote investor education, and \$7.5 million for failing to promptly produce all e-mail and thereby delaying by over a year the investigation as to Deutsche Bank Securities. Thomas Weisel Partners will pay a total of \$12.5 million: \$5 million in disgorgement, \$5 million as a penalty for various conflicts of interest, and \$2.5 million to fund independent research. Under the settlements, half of the disgorgement and penalty amounts will be paid by the firms in resolution of actions brought by the SEC, NYSE, and NASD, and will be put into funds to benefit customers of the firms. The remainder of the disgorgement and penalty amounts will be paid to the state securities regulators.

With respect to Deutsche Bank Securities' \$5 million for investor education, the SEC, NYSE, and NASD have authorized that \$2.5 million of these funds be added to the Investor Education Fund that the Court approved in the Global Settlement. The Investor Education Fund will, through the creation of an Investor Education Foundation, develop and support programs designed to equip investors with the knowledge and skills necessary to make informed decisions. The remaining \$2.5 million will be paid to state securities regulators and will be used for investor education purposes.

In addition to the monetary payments, Deutsche Bank Securities and Thomas Weisel Partners are required to comply with significant requirements that will dramatically reform their practices, including separating the research and investment banking departments at the firms, restructuring how research is reviewed and supervised, prohibiting analysts from receiving compensation for investment banking activities, and making independent research available to investors. These changes are consistent with those imposed against the ten firms in the Global Settlement.

Under the terms of the settlement, an injunction will be entered against each firm, enjoining it from violating the statutes and rules that it is alleged to have violated. The firms also have entered into the voluntary agreement restricting allocations of securities in hot IPOs to certain company executive officers and

directors, a practice known as "spinning," that originally was agreed to by the ten firms in the Global Settlement. The agreement is designed to promote fairness in the allocation of IPO shares and prevent the firms from using these shares to attract investment banking business.

### ***Summary of the Enforcement Actions***

The enforcement actions allege that, from approximately mid-1999 through mid-2001, the firms engaged in acts and practices that created or maintained inappropriate influence by investment banking over research analysts, thereby imposing conflicts of interest on research analysts that the firms failed to manage in an adequate or appropriate manner. In addition, the regulators found supervisory deficiencies at both firms. The enforcement actions, the allegations of which were neither admitted nor denied by the firms, also included additional charges:

- ▶ Deutsche Bank Securities and Thomas Weisel Partners issued research reports that were not based on principles of fair dealing and good faith and did not provide a sound basis for evaluating facts, contained exaggerated or unwarranted claims about the covered companies, and/or contained opinions for which there were no reasonable bases in violation of NYSE Rules 401, 472, and 476(a)(6), and NASD Rules 2110 and 2210 as well as state statutes.
- ▶ Deutsche Bank Securities and Thomas Weisel Partners received payments for research without disclosing such payments in violation of Section 17(b) of the Securities Act of 1933 as well as NYSE Rules 476(a)(6), 401, and 472 and NASD Rules 2210 and 2110. The firms also made undisclosed payments for research in violation of NYSE Rules 476(a)(6), 401, and 472 and NASD Rules 2210 and 2110 and state statutes.
- ▶ Deutsche Bank Securities failed to timely produce all e-mail communications that had been requested during the investigation, in violation of Section 17(b) of the Securities Exchange Act of 1934 as well as NYSE Rule 476(a)(11) and NASD Rule 2110. Deutsche Bank Securities had produced less than one-fourth of the responsive e-mail by April 2003, when the Global Settlement was concluded. Over the following year, Deutsche Bank Securities produced an additional 227,000 e-mails, more than tripling its original production.

To implement these settlements, the SEC filed separate actions against each firm in Federal District Court in New York City and, concurrently, NYSE and NASD completed disciplinary proceedings pursuant to the disciplinary procedures of their respective organizations. At the state level, California, which together with two other state regulators—Maryland and the District of Columbia—participated in the joint investigation of Deutsche Bank Securities, has agreed to resolve the case. California, which was the lead state participating in the Thomas Weisel investigation, also has reached an agreement with that firm. Model settlement agreements have been finalized and the NASAA Board of Directors has recommended that all states accept the terms of the agreements. The proposed Final Judgments in the SEC actions are subject to Court approval.

*Securities and Exchange Commission v. Deutsche Bank Securities Inc., 04 CV 06909 (WHP) (S.D.N.Y.); In re Deutsche Bank Securities Inc., HPD 04-128 (NYSE); Deutsche Bank Securities Inc., NASD Letter of Acceptance, Waiver, and Consent, CAF No. 040062.*

*Securities and Exchange Commission v. Thomas Weisel Partners LLC, 04 CV 06910 (WHP) (S.D.N.Y.); In re Thomas Weisel Partners LLC, HPD 04-129 (NYSE); Thomas Weisel Partners LLC, NASD Letter of Acceptance, Waiver, and Consent, CAF No. 040061.*