

NOVEMBER 2004

# Notice to Members

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Reported for November

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# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Continuing Education  
Executive Representatives  
Legal & Compliance  
Registered Representatives  
Senior Management  
Training

## KEY TOPICS

CCO  
CEO  
Certification  
Compliance  
Rule 3013  
Supervision

## GUIDANCE

### Annual Compliance Certification and Designation of Chief Compliance Officer

SEC Approves New Chief Executive Officer Compliance Certification and Chief Compliance Officer Designation Requirements; **Compliance Date: December 1, 2004**

#### Executive Summary

The Securities and Exchange Commission (SEC) has approved new NASD Rule 3013 and an accompanying interpretive material that requires members to (1) designate a chief compliance officer (CCO) and (2) have the chief executive officer (CEO) or equivalent officer certify annually that the member has in place processes to establish, maintain, review, test, and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules, and federal securities laws and regulations. Members must designate and identify to NASD on Schedule A of Form BD a principal to serve as CCO by December 1, 2004. The CEO certification must be executed within one year of December 1, 2004 and annually thereafter. The new rule language and interpretive material can be found here in Attachment A.

#### Questions/Further Information

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

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## Background and Discussion

NASD Rule 3013 is intended to bolster attention to members' compliance programs by requiring substantial and purposeful interaction between business and compliance officers throughout the firm. To that end, the rule requires each member to designate a CCO and further requires that the CEO certify annually that the member has in place processes to establish, maintain, review, modify, and test policies and procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules, and federal securities laws and regulations.

The certification language and additional guidance are set forth in Interpretive Material (IM) 3013. The certification includes not only a statement that the member has in place certain compliance processes, but also that the CEO has conducted one or more meetings with the CCO in the preceding 12 months to discuss the processes. The interpretive material explains that the mandated meetings between the CEO and CCO must include a discussion of the member's compliance efforts to date and identify and address significant compliance problems and plans for emerging business areas. NASD notes that for certain members, the size, nature, and complexity of their business may warrant more than one annual meeting between the CEO and CCO.

The certification also includes a declaration that the CEO has consulted with the CCO and such other officers, employees, outside consultants, lawyers, and accountants, to the extent necessary to attest to the statements in the certification.

The processes must be evidenced in a report that is provided to the member's board of directors and audit committee. The report must be produced prior to execution of the certification and be reviewed by the CEO, CCO, and any other officers the member deems necessary to make the certification. It should include the manner and frequency in which the processes are administered, as well as the identification of officers and supervisors who have responsibility for such administration. The report need not contain any conclusions resulting from the processes set forth therein. The report may be combined with any other compliance report or other similar report required by any other self-regulatory organization provided it meets certain requirements set forth in the interpretive material.

The designated CCO may hold another position within the member, so long as that person can discharge the duties of the CCO in light of his or her other additional responsibilities. The interpretive material describes the obligations of the CCO with respect to a member's compliance scheme and the indispensable role the CCO must play to enable the CEO to make the certification.

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Finally, the interpretive material notes that supervisors with business line responsibility remain accountable for the discharge of a member's compliance policies and written supervisory procedures. The signatory to the certification is certifying only as to having processes in place to establish, maintain, review, test, and modify the member's written compliance and supervisory policies and procedures. It further states that the execution of the certification and any consultation rendered in connection with such certification does not by itself establish business line responsibility.

Members must maintain the certification and report in their files for inspection, but do not need to send them to NASD.

### Compliance Date

The rule becomes effective on December 1, 2004. Members therefore will be required to designate and identify to NASD on Schedule A of Form BD a principal to serve as CCO by that effective date. The CEO certification must be executed within one year after the effective date and annually thereafter.

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## **ATTACHMENT A**

### **3013. Annual Certification of Compliance and Supervisory Processes**

#### **(a) Designation of Chief Compliance Officer**

Each member shall designate and specifically identify to NASD on Schedule A of Form BD a principal to serve as chief compliance officer.

#### **(b) Annual Certification**

Each member shall have its chief executive officer (or equivalent officer) certify annually<sup>1</sup>, as set forth in IM-3013, that the member has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations, and that the chief executive officer has conducted one or more meetings with the chief compliance officer in the preceding 12 months to discuss such processes.

### **IM-3013. Annual Compliance and Supervision Certification**

The NASD Board of Governors is issuing this interpretation to the requirement under Rule 3013(b), which requires that the member's chief executive officer (or equivalent officer) execute annually<sup>1</sup> certification that the member has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations. The certification shall state the following:

\* \* \*

#### **Annual Compliance and Supervision Certification**

The undersigned is the chief executive officer (or equivalent officer) of [name of member corporation/partnership/sole proprietorship] (the "Member"). As required by NASD Rule 3013(b), the undersigned makes the following certification:

1. The Member has in place processes to:

(a) establish, maintain and review policies and procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations;

(b) modify such policies and procedures as business, regulatory and legislative changes and events dictate; and

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(c) test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with NASD rules, MSRB rules and federal securities laws and regulations.

2. The undersigned chief executive officer (or equivalent officer) has conducted one or more meetings with the chief compliance officer in the preceding 12 months, the subject of which satisfy the obligations set forth in IM-3013.

3. The Member's processes, with respect to paragraph 1 above, are evidenced in a report reviewed by the chief executive officer (or equivalent officer), chief compliance officer, and such other officers as the Member may deem necessary to make this certification, and submitted to the Member's board of directors and audit committee.

4. The undersigned chief executive officer (or equivalent officer) has consulted with the chief compliance officer and other officers as applicable (referenced in paragraph 2 above) and such other employees, outside consultants, lawyers and accountants, to the extent deemed appropriate, in order to attest to the statements made in this certification.<sup>2</sup>

\* \* \*

It is critical that each NASD member understand the importance of employing comprehensive and effective compliance policies and written supervisory procedures. Compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations is the foundation of ensuring investor protection and market integrity and is essential to the efficacy of self-regulation. Consequently, the certification requirement is intended to require processes by each member to establish, maintain, review, test and modify its compliance policies and written supervisory procedures in light of the nature of its businesses and the laws and rules that are applicable thereto, and to evidence such processes in a report reviewed by the chief executive officer (or equivalent officer) executing the certification.

Included in this processes requirement is an obligation on the part of the member to conduct one or more meetings annually between the chief executive officer (or equivalent officer) and the chief compliance officer to: (1) discuss and review the matters that are the subject of the certification; (2) discuss and review the member's compliance efforts as of the date of such meetings; and (3) identify and address significant compliance problems and plans for emerging business areas.

The periodic and content requirements for meetings between the chief executive officer (or equivalent officer) and the chief compliance officer, as well as the pertinent requirements of paragraphs 3 and 4 of the certification, are intended to indicate the unique and integral role of the chief compliance officer both in the discharge of certain compliance processes and reporting requirements that are the subject matter of the certification and in providing a reliable basis upon which the chief executive officer can execute the certification. The chief compliance officer is the primary advisor to the member on its overall compliance scheme and the particularized rules, policies and procedures that the member adopts. This is because the chief compliance officer should have an expertise in the process of

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(1) gaining an understanding of the products, services or line functions that need to be the subject of written compliance policies and written supervisory procedures; (2) identifying the relevant rules, regulations, laws and standards of conduct pertaining to such products, services or line functions based on experience and/or consultation with those persons who have a technical expertise in such areas of the member's business; (3) developing, or advising other business persons charged with the obligation to develop, policies and procedures that are reasonably designed to achieve compliance with those relevant rules, regulations, laws and standards of conduct; (4) evidencing the supervision by the line managers who are responsible for the execution of compliance policies; and (5) developing programs to test compliance with the member's policies and procedures.

It is that expertise in the process of compliance that makes the chief compliance officer an indispensable party to enable the chief executive officer to reach the conclusions stated in the certification. Consequently, any certification made by a chief executive officer under circumstances where the chief compliance officer has concluded, after consultation, that there is an inadequate basis for making such certification would be, without limitation, conduct inconsistent with the observance of the high standards of commercial honor and the just and equitable principles of trade – a violation of Rule 2110. Beyond the certification requirement, it is the intention of both Rule 3013 and this Interpretive Material to foster regular and significant interaction between senior management and the chief compliance officer regarding the member's comprehensive compliance program.

The chief compliance officer and other compliance officers that report to the chief compliance officer (as described in the sentence that immediately follows) shall perform the compliance functions contemplated by this Interpretive Material and paragraphs 3 and 4 of the certification. Nothing in this Interpretive Material is intended to limit or discourage the participation of other employees both within and without the member's compliance department in any aspect of the member's compliance programs or processes, including those matters discussed in this Interpretive Material. However, it is understood that the chief compliance officer and, where applicable, the most senior compliance officers having primary compliance department responsibility for each of the member's business segments, will retain responsibility for the compliance functions contemplated by this Interpretive Material and paragraphs 3 and 4 of the certification.

As may be necessary to render their views and advice, the chief compliance officer and the other officers referenced in paragraph 3 of the certification who consult with the chief executive officer (or equivalent officer) pursuant to paragraph 4, shall, in turn, consult with other employees, officers, outside consultants, lawyers and accountants.

The NASD Board of Governors recognizes that supervisors with business line responsibility are accountable for the discharge of a member's compliance policies and written supervisory procedures. The signatory to the certification is certifying only as to having processes in place to establish, maintain, review, test and modify the member's written compliance and supervisory policies and procedures and the execution of this certification and any consultation rendered in connection with such certification does not by itself establish business line responsibility.

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The requirement to designate a chief compliance officer does not preclude such person from holding any other position within the member, including the position of chief executive officer, provided that such person can discharge the duties of a chief compliance officer in light of his or her other additional responsibilities. The requirement that a member's processes include providing the report to the board of directors and audit committee (required by paragraph 3 of the certification) does not apply to members that do not utilize these types of governing bodies and committees in the conduct of their business.<sup>3</sup>

The report required in paragraph 3 of the certification must document the member's processes for establishing, maintaining, reviewing, testing and modifying compliance policies, that are reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations, and any principal designated by the member may prepare the report. The report must be produced prior to execution of the certification and be reviewed by the chief executive officer (or equivalent officer), chief compliance officer and any other officers the member deems necessary to make the certification and must be provided to the member's board of directors and audit committee. The report should include the manner and frequency in which the processes are administered, as well as the identification of officers and supervisors who have responsibility for such administration. The report need not contain any conclusions produced as a result of following the processes set forth therein. The report may be combined with any other compliance report or other similar report required by any other self-regulatory organization provided that (1) such report is clearly titled in a manner indicating that it is responsive to the requirements of the certification and this Interpretive Material; (2) a member that submits a report for review in response to an NASD request must submit the report in its entirety; and (3) the member makes such report in a timely manner, i.e., annually.

- 1 Members must ensure that each ensuing annual certification is effected no later than on the anniversary date of the previous year's certification.
- 2 Members should understand that the requirements of Rule 3013 and this Interpretive Material represent, in part, a principle-based requirement to certify that the member has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, MSRB rules and federal securities laws and regulations. Consequently, compliance with the periodic and content requirements in this Interpretive Material pertaining to meetings between the chief executive officer (or equivalent officer) and the chief compliance officer does not satisfy the full extent of these principle-based obligations that will vary with the facts and circumstances of a member's business activities and organizational structure. Moreover, NASD emphasizes the testing aspect of this principle-based requirement; an integral purpose of NASD rules pertaining to supervision is that members adopt policies and procedures that are effective as to both the scope of, and the achievement of compliance with, applicable NASD rules, MSRB rules and federal securities laws and regulations.
- 3 As a part of their process, members must have the report reviewed by their governing bodies and committees that serve similar functions in lieu of a board of directors and audit committee.

# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Internal Audit  
Legal & Compliance  
Operations  
Registered Representatives  
Senior Management  
Systems  
Trading

## KEY TOPICS

OATS

## REQUEST FOR COMMENT

### Order Audit Trail System (OATS)

NASD Seeks Comment on Proposed Changes to the OATS Rules; **Comment Period Expires January 20, 2005**

#### Executive Summary

NASD is issuing this *Notice to Members* to solicit comments from members and other interested parties on proposed changes to the OATS Rules (Rules 6950 through 6957). The OATS Rules impose obligations on member firms to record in electronic form and report to NASD on a daily basis certain information with respect to orders originated or received by NASD members relating to securities listed and traded on The Nasdaq Stock Market, Inc. (NASDAQ). NASD staff is seeking comment on three proposed changes to the OATS Rules, which would require members to record and report to OATS:

- ▶ Order information relating to exchange-listed and OTC equity securities (OTC Bulletin Board (OTCBB) and Pink Sheets);
- ▶ Enhanced information, including execution data, relating to orders routed to non-members or exchanges; and
- ▶ Order information relating to proprietary orders generated during the course of market-making activities.

NASD believes this additional information will enable NASD to create a more comprehensive and accurate order and transaction audit trail and significantly improve the effectiveness of NASD's automated surveillance for potential violations of NASD rules and the federal securities laws.

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## Action Requested

NASD encourages all interested parties to comment on these three proposals. Comments must be received by January 20, 2005. Members and interested persons can submit their comments using the following methods:

- ▶ Mailing in Attachment A—Request for Comment Form—along with written comments;
- ▶ Mailing comments in hard copy to the address below;
- ▶ E-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com); or

To help NASD process and review comments more efficiently, persons commenting on this proposal should use only one method; however, if a person wishes to submit comments using both the Request for Comment Form and one of the other methods listed above, he or she should indicate that in the submissions. The Request for Comment Form and/or comments sent by hard copy should be mailed to:

Barbara Z. Sweeney  
Office of the Corporate Secretary  
NASD  
1735 K Street, N.W.  
Washington, D.C. 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>1</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>2</sup>

## Questions/Further Information

As noted above, hard copy comments should be mailed to Barbara Z. Sweeney. Questions concerning this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8071.

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## Background and Discussion

The OATS Rules impose obligations on member firms to record in electronic form and report to NASD on a daily basis certain information with respect to orders originated or received by NASD members relating to securities listed and traded on NASDAQ. OATS captures this order information reported by NASD members to create a time-sequenced record of orders and transactions. This information is critical to NASD staff in conducting surveillance and investigations of member firms for violations of federal securities laws and NASD rules.

Given a number of factors, including the fragmentation in the trading of securities over the past several years and the need to enhance NASD's automated surveillance program, NASD staff has identified several enhancements to the current OATS information that would enable it to create a more comprehensive and accurate order and transaction audit trail. These proposed changes would significantly enhance NASD's ability to surveil for potential violations of NASD rules and the federal securities laws. NASD staff believes that continued effective automated surveillance will be difficult to achieve without the proposed expansion of order information captured by OATS, as described herein.

Therefore, NASD is soliciting comment on three proposed changes to the OATS Rules. The proposed changes would require members to record and report to OATS (1) order information relating to orders and transactions in exchange-listed and OTC equity securities; (2) enhanced information, including execution data, relating to orders routed to non-members or exchanges; and (3) order information relating to proprietary orders generated during the course of market-making.

### **1. Proposed Changes to Expand OATS Requirements to Apply to Orders and Transactions in Exchange-Listed and OTC Equity Securities.**

Because OATS requirements do not apply to exchange-listed or OTC equity securities, NASD staff currently is unable to recreate on an automated basis an order and transaction audit trail for these securities and is therefore unable to conduct certain automated surveillance for exchange-listed and OTC equity securities comparable to the current automated surveillance program it has established for trading in Nasdaq securities. For example, expansion of the OATS requirements to exchange-listed and OTC equity securities would enhance NASD staff's ability to review and examine, on a more automated basis, for compliance with Limit Order Protection (IM-2110-2), the duty of best execution (Rule 2320), Short Sales (SEC Rule 10a-1), and the Limit Order Display Rule (SEC Rule 11Ac1-4), among others. As a result, NASD is soliciting comment on a proposal to extend the OATS requirements to order activity and transactions in these securities.

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Under the proposal, NASD members would be required to report to OATS order-related activities for exchange-listed securities, irrespective of whether the order is ultimately executed over-the-counter or on or through an exchange. Because it is sometimes unlikely that a member knows upon receipt of an order where the order will be executed, NASD members would need to report such information to OATS regardless of how the order is ultimately handled or where it is executed. As described in more detail below, if NASD does not have a complete picture of the trading by an NASD member, including executions on or through an exchange, potential violations may be missed. However, given that the NYSE has established its own Order Tracking System (OTS), NASD staff will work to coordinate any proposed requirements relating to NYSE securities with the OTS requirements to minimize the potential for duplicative reporting of order information. To the extent that other exchanges have established comparable order audit trail systems, NASD would endeavor to coordinate its proposed requirements with those exchanges as well.

## **2. Proposed Changes to Enhance the OATS Information Reported for Orders Routed to Exchanges or Non-Members.**

Currently, members that route orders to non-members or exchanges for execution are not required to provide OATS information beyond the route to that non-member or exchange.<sup>3</sup> As a result, NASD does not receive automated data for the portion of a member's trading activities that occurs on or through a non-member or exchange. NASD staff has determined that gaps can exist in its automated surveillance of member activities when NASD does not receive a complete picture of the member's order and trading activity. Accordingly, NASD is soliciting comment on a proposal to require members to record and report to OATS order events relating to orders routed to non-members or exchanges.

In particular, NASD is soliciting comment on the scope of order-related information that members have access to with respect to orders they have routed to non-members and exchanges. To ensure that NASD can link and recreate the entire lifecycle of the order, NASD members would need to report to OATS order events relating to orders routed to non-members or exchanges, including, but not limited to, new order, subsequent routing and execution information. Such information would be necessary in conducting automated surveillance for member compliance with NASD rules and the federal securities laws, including Limit Order Protection. NASD seeks input on what information relating to the handling of a member's order by a non-member or exchange currently is accessible to the member and, as applicable, the burdens associated with obtaining and reporting additional information to OATS. In this context, NASD is sensitive to self-regulatory organization (SRO) jurisdictional issues and is not seeking information about conduct that is clearly outside its jurisdiction and within the jurisdiction of the routed exchange, such as specialist or floor broker activity.

As permitted today under Rule 6955(c), members would be able to enter into reporting agent agreements with a non-member or exchange to report OATS information on the member's behalf. However, the member remains liable for the proper reporting and accuracy of data reported on the member's behalf by a reporting agent.

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### 3. Proposed Changes to Eliminate Current Exceptions for Market Makers.

Members currently are not required to report to OATS proprietary orders generated during the course of market-making. Although certain information such as trade report information may be available for market making trades, NASD does not receive automated information on the entire lifecycle of a market-making proprietary order. For example, market-making proprietary orders that do not result in executions or are executed on exchanges or through non-members currently are not captured by or provided to NASD on an automated basis. This information can be particularly important where a proprietary order is routed in place of a pending customer order. Because members currently are not required to report this information to OATS, NASD staff does not always have a complete picture of a member's order and trading activities. NASD believes that this information pertaining to proprietary orders of market makers is critical for surveillance purposes, including reviews for compliance with the Limit Order Protection Rule, the Limit Order Display Rule, and Firm Quote Requirements (NASD Rule 3320 and SEC Rule 11Ac1-1(c)). NASD therefore is soliciting comment on a proposal that would require members to report to OATS information relating to proprietary orders generated during the course of market-making.

### Endnotes

1. See *Notice to Members 03-73* (November 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.
2. 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.
3. NASD does receive OATS information for certain orders that are executed on an exchange, but it depends on whether the order is routed to the exchange for handling and execution or if the order is executed by the member and only trade reported to the exchange. Under the first scenario, the member would provide OATS information relating to the new order and the route of the order to an exchange, but would not provide OATS information regarding the ultimate execution of the order. With respect to an order that is executed by a member and then reported to an exchange, the member would be required to record and report to OATS new order and execution information. See *The OATS Report December 2002 (OATS Reporting Responsibilities for Orders Routed to, or Executions Reported on, Other Securities Exchanges)*, available at [www.nasd.com](http://www.nasd.com).

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## ATTACHMENT A

### Request for Comment Form

We have provided below a form that members and other interested parties may use in addition to or in lieu of written comments. This form is intended to offer a convenient way to participate in the comment process, but does not cover all aspects of the proposal described in the Notice. We therefore encourage members and other interested parties to review the entire Notice and provide written comments, as necessary.

### Instructions

Comments must be received by January 20, 2005. Members and interested persons can submit their comments using the following methods:

- ▶ Mailing in Attachment A—Request for Comment Form—along with written comments;
- ▶ Mailing comments in hard copy to the address below;
- ▶ E-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com); or

To help NASD process and review comments more efficiently, persons commenting on this proposal should use only one method; however, if a person wishes to submit comments using both the Request for Comment Form and one of the other methods listed above, he or she should indicate that in the submissions. The Request for Comment Form and/or comments sent by hard copy should be mailed to:

Barbara Z. Sweeney  
Office of the Corporate Secretary  
NASD  
1735 K Street, N.W.  
Washington, D.C. 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.

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*.

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## Proposed Changes to OATS Rules

The staff requests input from members and other interested parties on any or all of the three proposed changes to the OATS Rules described in this *Notice*. In particular, the staff seeks comment on the technological implications and burdens of each of the proposals.

### Expansion of OATS to Exchange-Listed and OTC Equity Securities

1. Do you support the proposal that would require that members record and report OATS information for exchange-listed and OTC equity securities?  
 Yes    No    See my attached written comments.
2. What are the technological implications and burdens associated with this proposal?
3. Is the data you record and maintain to comply with the NYSE's OTS requirements in a similar form as the data you maintain for NASD OATS purposes? What additional changes would be necessary to enable members to submit the NYSE OTS data to NASD OATS?

### Expansion of OATS to Orders Routed to Non-Members or Exchanges

4. Do you support the proposal that would require that members record and report OATS order events relating to orders routed to non-members or exchanges?  
 Yes    No    See my attached written comments.
5. Describe the scope and type of order-related information that a member currently has access to when it has routed an order to a non-member or exchange. For example, if an order is routed to and then executed by a non-member, what execution information is provided to the member that routed the order? Does the member typically have knowledge of whether the order was further routed by the non-member or exchange, and if so, what level of detail is provided to the member?
6. What are the technological implications and burdens associated with this proposal, including requirements that potentially could expand the scope of information provided by non-members and exchanges to members that have routed orders to them?

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## Expansion of OATS to Market Making Proprietary Orders

7. Do you support the proposal that would require that members record and report OATS information for OATS proprietary orders generated during the course of market-making?

Yes     No     See my attached written comments.

8. What are the technological implications and burdens associated with this proposal?

## Implementation

9. NASD anticipates proposing a "phase-in" period for implementation of any of the proposals described herein to provide members with adequate time for necessary system and procedural modifications. What amount of time do you believe is adequate for implementation of the proposals?

## Contact Information

Name: \_\_\_\_\_

Firm: \_\_\_\_\_

Address: \_\_\_\_\_

City/State/Zip: \_\_\_\_\_

Phone: \_\_\_\_\_

E-mail: \_\_\_\_\_

### Are you:

An NASD Member

An Investor

A Registered Representative

Other: \_\_\_\_\_

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# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Continuing Education  
Executive Representatives  
Legal & Compliance  
Registered Representatives  
Registration  
Research  
Senior Management  
Training

## KEY TOPICS

Qualification Examinations  
Registration  
Research Reports  
Rule 1050  
Supervision

## GUIDANCE

### Research Analysts and Research Reports

SEC Approves New NASD Qualification Requirements for Supervisors of Research Analysts; **Compliance Date: No Later Than August 2, 2005**

#### Executive Summary

The Securities and Exchange Commission (SEC) has approved a new NASD rule that requires supervisors of equity research analysts to pass either the Series 87 or the New York Stock Exchange (NYSE) Series 16 Supervisory Analyst qualification examination. This new rule augments the existing requirement that supervisors of research analysts must be registered as a General Securities Principal. Members may apply for registration Research Principal (RP) through Web CRD beginning on April 4, 2005, and individuals must satisfy the qualification requirements by August 2, 2005. While the Series 16 and Series 87 are currently available, due to system constraints, the Research Principal (RP) registration category will not be available until April 4, 2005. The new rule language is attached as Attachment A.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to Philip Shaikun, Associate General Counsel, Regulatory Policy and Oversight, at (202) 728-8451; Joe McDonald, Associate Director, NASD Testing and Continuing Education Department, at (240) 386-5065; or Carole Hartzog, Senior Analyst, NASD Testing and Continuing Education Department, at (240) 386-4678.

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## Background and Discussion

NASD Rule 1050 requires all persons associated with a member who function as research analysts to be registered as such with NASD and pass a qualification examination. Those individuals required to be registered as research analysts must pass the Research Analyst Qualification Examination (Series 86/87) or qualify for an exemption. That examination consists of two parts: Analysis (Series 86) tests fundamental analysis and valuation of equity securities; and Regulatory Administration and Best Practices (Series 87) tests knowledge of applicable rules and regulations, including NASD Rule 2711, NYSE Rule 344, and SEC Regulation AC.

For dual NASD/NYSE members, NASD currently permits either a Series 16 Supervisory Analyst or a Series 24 General Securities Principal to approve the *content* of research reports under the advertising rule (Rule 2210) and to review research reports for the applicable conflict of interest disclosures required by Rule 2711(h). If a dual member elects to have a Series 16 Supervisory Analyst approve the content of a research report, NASD requires a Series 24 General Securities Principal to supervise all other conduct of an individual who functions as a research analyst. NASD-only members are currently required to have a Series 24 General Securities Principal to both approve the content of research reports and supervise the conduct of research analysts. The General Securities Principal Qualification Examination Sales Supervisor Module (Series 23) is an acceptable alternative to the General Securities Principal Examination (Series 24).

The SEC has now approved amendments to NASD Rule 1022 to require supervisors of equity research analysts to pass the Series 87 or the Series 16.

Under the new rule NASD will permit dual NASD/NYSE members or NASD-only members to have the content of research approved by someone who has passed either (1) the Series 24 and the Series 87 or (2) the Series 16. If the member elects to have a Series 16 approve the content of research, then a Series 24 principal who has also passed either the Series 87 or the Series 16 must supervise the conduct of both the Series 16 Supervisory Analyst and the research analyst. Thus, the rule provides members with some flexibility in their supervisory structure for research analysts.

NASD believes this rule will promote investor protection by ensuring that persons responsible for approving research reports and for providing general supervision of the conduct of research analysts have demonstrable knowledge of Rule 2711 and related analyst conflict of interest laws, rules and regulations. At the same time, the rule preserves the longstanding NASD requirement that a General Securities Principal be responsible for the general conduct of a registered person.

All persons who supervise research analysts must satisfy these qualification requirements—there is no “grandfather” provision. However, NASD believes the compliance date of no later than August 2, 2005 provides adequate time for research supervisors to prepare for the examination and will avoid any disruption of the research desk.

NASD does not intend to grant waivers of the Series 87.

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## Registration Filing Requirements and Exam Fees

Beginning April 4, 2005, members may submit through Web CRD<sup>1</sup> a Uniform Application for Securities Industry Registration or Transfer Form (Form U4) to register as a Research Principal (RP) any person who functions in such capacity. Those individuals will then have until August 2, 2005 to pass the requisite examinations—the Supervisory Analyst (Series 16) or the Regulatory Administration and Best Practices part of the Research Analyst Exam (Series 87) in addition to the Series 23 or 24. The exam fees for the Series 87 and Series 16 are \$100<sup>1</sup> and \$200, respectively.

Currently, the Series 87 can only be scheduled when requesting registration as a Research Analyst and an exam window opens for both the Series 86 and Series 87. Due to system constraints, refunds of the Series 86 exam fee will not be provided to research principals who request the Series before April 4, 2005. Due to system constraints, the Research Principal registration category will be available on Web CRD effective April 4, 2005, at which time:

- ▶ Web CRD will accept requests for the Research Principal registration via page one of Form U4.
- ▶ The Series 87 will be a stand-alone examination *only* for purposes of the Research Principal registration.
- ▶ An NASD Supervisory Analyst registration category will be added to Web CRD (NASD-SA) for candidates who have passed the Series 16.

Research Principals who have passed the General Securities Principal exam and Series 16 or Series 87 before April 4, 2005 and whose registrations are current will have to request the registration category RP on or after April 4, 2005, and before August 2, 2005, by submitting a page 1 to the Form U4 on Web CRD.

## Exam Content

The Series 87 qualification exam—Regulatory Administration and Best Practices—consists of 50 multiple-choice questions that cover relevant federal and industry rules and regulations. Candidates are allowed 90 minutes to complete the examination. Since multiple forms of the examination will be administered, the passing score for the Series 87 will fluctuate moderately from examination to examination.

The Series 16 consists of two parts: Regulatory Administration (Part I) and Securities Analysis (Part II). Part I consists of 50 multiple-choice questions that cover relevant NYSE rules, as well as the applicable provisions of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisers Act of 1940. Candidates are allowed 90 minutes to complete this part. Part II consists of 50 multiple-choice questions that cover various topics pertaining to securities analysis, including accounting, economics, and fundamental and technical analysis, among others. Candidates are allowed 120 minutes to complete this part.

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With respect to both the Series 87 and Series 16 examinations, candidates will be given an informational breakdown of their performance on each of the sections, along with their overall score and grade at the completion of each exam session.

A study outline has been prepared to assist member firms in preparing candidates for the Series 87 examination and is available at [www.nasdr.com/analyst\\_guide.asp](http://www.nasdr.com/analyst_guide.asp). The content outline for the Series 16 is available at [www.nyse.com/pdfs/series16.pdf](http://www.nyse.com/pdfs/series16.pdf). Members may wish to use the study outline to structure or prepare training material, or develop lecture notes and seminar programs, and as a training aide for the candidates.

The questions used in these examinations will be updated to reflect the most current interpretations of the rules and regulations on which they are based. Questions on new rules will be added to the pool of questions for these examinations within a reasonable time period of the effective dates of those rules. Questions on rescinded rules will be promptly deleted from the pool of questions. Candidates only will be asked questions pertaining to rules that are effective at the time they take the exam.

These tests are administered as closed-book exams. Severe penalties, up to and including expulsion from the industry, are imposed on candidates who cheat on NASD-administered examinations. The proctor will provide scratch paper and a *basic electronic calculator* to candidates. These items must be returned to the proctor at the end of the session.

The Series 87 examination and Series 16 Supervisory Analyst examination are administered at conveniently located test centers operated by Pearson Vue and Prometric professional testing center networks. Appointments to take the examinations 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.

## Compliance Date

The registration and qualification requirements for supervisors of research analysts become effective on August 2, 2005. Any member firm whose Research Principal is not properly registered by that date will be in violation of NASD IM-1000-3 and Rule 1022(a)(5).

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## Frequently Asked Questions

1. **I am currently registered as a General Securities Principal. To qualify as a Research Principal (RP), will I be able to request the Series 16 exam in lieu of the Series 87 exam even if I am employed by an NASD-only member firm?**

Yes. Because Web CRD will recognize the Series 16 as a valid examination effective April 4, 2005, you should wait until then to request both the Series 16 exam and the RP registration.

2. **Since the Series 87 is currently being administered, can I sit for it now and receive the RP approval on April 4, 2005?**

Yes. However, if you open a window to take the Series 87 before April 4, 2005, you will be charged exam fees for both the Series 86 and 87 (due to system constraints that will be resolved effective April 4, 2005) and cannot obtain approval as a Research Principal because this registration category will not be available on Web CRD until April 4, 2005. If you choose to take the Series 87 before April 4, 2005, you will have to submit a page one of the Form U4 on Web CRD to request the "RP" registration after that date. Note that refunds of the Series 86 exam fee will not be provided. Effective April 4, 2005, you may open a window to take the Series 87 only.

3. **If a General Securities Principal fails the Series 16 or the Series 87, will there be a waiting period before the test can be retaken?**

The usual policy regarding waiting periods for candidates retaking a failed exam will apply to the Series 16 and Series 87 as well as the Series 23 and 24. Typically, a candidate must wait 30 days before retaking a failed exam and 180 days after the third and all subsequent failures.

4. **What happens if I do not pass the Series 16 or Series 87 by August 2, 2005?**

Since there is no grace period to satisfy this requirement, you will have to cease functioning as a Research Principal. If your firm has no other registered Research Principal, it will have to cease issuing research reports.

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5. If an individual supervises fixed income or municipal securities research analysts, do these new qualification requirements apply?

No. All supervisors of research analysts must be registered as principals in the category appropriate for their function. The new qualification requirements apply only to supervisors of *equity* research reports. Individuals who supervise fixed income analysts and approve fixed income research reports must have the Series 23 or 24 exam. Individuals who supervise municipal securities analysts and approve municipal securities research reports must have the Series 53 exam.

### Endnote

- 1 The fee for the Series 87 examination will increase to \$105 beginning January 1, 2005. See *Notice to Members 04-73* (October 8, 2004)

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### 1022. Categories of Principal Registration

#### (a) General Securities Principal

(1) through (4) No change.

(5) A person registered solely as a General Securities Principal shall not be qualified to supervise the conduct of a "research analyst" as defined in Rule 1050, or a supervisory analyst qualified pursuant to Rule 344 of the New York Stock Exchange who approves research reports on equity securities as permitted by Rule 2210(b)(1), unless such principal has passed a Qualification Examination as specified by the Board of Governors.

# Special Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registration  
Senior Management

## KEY TOPICS

District Elections

INFORMATIONAL

## District Elections

NASD Announces Election Results for District Committees and District Nominating Committees

### Executive Summary

Through this *Notice*, NASD announces the election results for the District Committees and the District Nominating Committees. The candidates nominated to the District Committees have been duly elected in Districts 2 through 9, and in District 11. The candidates nominated to the District Nominating Committees have been duly elected in all districts. The newly elected District Committee members will serve until January 2008,<sup>1</sup> and the newly elected District Nominating Committee members will serve until January 2006.

In District 1 (San Francisco) and District 10 (New York), an additional candidate has satisfied the requirements of Article VIII of the By-Laws of NASD Regulation to contest the District Committee election. The outcome of these contested elections will be announced in a Notice to Members issued in January 2005.

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

### Questions/Further Information

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

<sup>1</sup> Some District Committee members were elected to fill existing vacancies and therefore may serve less than a three-year term, as indicated on Attachment A.

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## ATTACHMENT A

### District Committees and District Nominating Committees – 2005 Incoming Members

#### District 1

Elisabeth P. Owens, Regional Director, West Region

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

(415) 882-1200

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

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#### District 1 Committee Incoming Members

To Be Announced

#### District 1 Nominating Committee Incoming Members

Robert S. Basso	National Financial Services, LLC	San Francisco, CA
L. Robert McKulla	Wachovia Securities, Inc.	Walnut Creek, CA
Robert A. Muh	Sutter Securities, Inc.	San Francisco, CA
G. Stuart Spence	UBS Financial Services, Inc.	San Francisco, CA
Samuel Yates	RBC Dain Rauscher	San Francisco, CA

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## District 2

Lani M. Sen Woltmann, District Director

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

(213) 229-2300

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

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### District 2 Committee Incoming Members

Kenneth R. Hyman	Partnervest Securities, Inc.	Santa Barbara, CA
Ismael Manzanares, Jr. (1-Year Term)	Foresters Equity Securities, Inc.	San Diego, CA
Bryan R. Plank	Merrill Lynch	San Diego, CA
Valorie Seyfert	CUSO Financial Services, L.P.	San Diego, CA

### District 2 Nominating Committee Incoming Members

James E. Biddle	The Securities Center Incorporated	Chula Vista, CA
Terry L. Chase	Wachovia Securities, Inc.	Pasadena, CA
Richard B. Gunter	Wedbush Morgan Securities	Los Angeles, CA
Steven K. McGinnis		Irvine, CA
Joel H. Ravitz	Quincy Cass Associates	Los Angeles, CA

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**District 3**

**Joseph M. McCarthy**, District Director  
370 17th Street, Suite 2900  
Denver, CO 80202-5629  
(303) 446-3100

**James G. Dawson**, District Director  
Two Union Square, 601 Union Street  
Suite 1616, Seattle, WA 98101-2327  
(206) 624-0790

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

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

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**District 3 Committee Incoming Members**

<b>Kathryn M. Dominick</b>	TCAdvisors Network, Inc.	Englewood, CO
<b>Craig A. Jackson</b>	Northwest Consulting, LLC	Roseburg, OR
<b>Harry L. Striplin</b>	Paulson Investment Company, Inc.	Portland, OR

**District 3 Nominating Committee Incoming Members**

<b>Gregory R. Anderson</b>	TIAA-CREF Individual & Institutional Services, LLC	Denver, CO
<b>Elyssa S. Baltazar</b>	Morgan Stanley Dean Witter, Inc.	Denver, CO
<b>Thomas R. Hislop</b>	Peacock, Hislop, Staley & Given, Inc.	Phoenix, AZ
<b>Clarence Fredrick Roed</b>	RBC Dain Rauscher	Bellevue, WA
<b>Kathryn A. Supko</b>	Northwestern Mutual Investment Services, LLC	Boise, ID

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**District 4**

Thomas D. Clough, District Director

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

(816) 421-5700

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

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**District 4 Committee Incoming Members**

Allen J. Moore	SMITH HAYES Financial Services	Lincoln, NE
Stephen R. Oliver	Gold Capital Management, Inc.	Overland Park, KS
Minoos Spellerberg	Princor Financial Services Corporation	Des Moines, IA

**District 4 Nominating Committee Incoming Members**

Frank H. Kirk	Wachovia Securities LLC	Kansas City, MO
Timothy J. Lyle	Cambridge Investment Research	Fairfield, IA
Jeffrey A. Schuh	Residential Funding Securities Corp.	Minneapolis, MN
James H. Warner	The Warner Group	Sioux City, IA
Pamela R. Ziermann	Dougherty & Company LLC	Minneapolis, MN

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## **District 5**

Warren A. Butler, Jr., Regional Director, South Region

1100 Poydras Street, Energy Centre, Suite 850, New Orleans, LA 70163-0802

(504) 522-6527

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

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### **District 5 Committee Incoming Members**

Philip J. Dorsey	Dorsey & Company, Inc.	New Orleans, LA
Fred G. Eason	Delta Trust Investments, Inc.	Little Rock, AR
Harold L. Gladney	Vining Sparks IBG, L.P.	Memphis, TN

### **District 5 Nominating Committee Incoming Members**

John J. Dardis	Jack Dardis & Associates, Ltd.	Metairie, LA
David A. Knight	Stephens, Inc.	Little Rock, AR
LeRoy H. Paris, II	Invest Linc Securities, Inc.	Jackson, MS
Tom R. Steele	Equitable Advisors, Inc.	Nashville, TN
David W. Wiley, III	Wiley Bros., Aintree Capital, LLC	Nashville, TN

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**District 6**

Virginia F. M. Jans, District Director

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

(972) 701-8554

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*Texas*

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**District 6 Committee Incoming Members**

Bryan T. Emerson	Starlight Investments, LLC	Houston, TX
Michael A. Pagano	1st Global Capital Corporation	Dallas, TX
William H. Lowell	Lowell & Co., Inc.	Lubbock, TX

**District 6 Nominating Committee Incoming Members**

Christopher R. Allison	M.E. Allison & Co., Inc.	San Antonio, TX
Sennett Kirk, III	Kirk Securities Corporation	Denton, TX
William B. Madden	Madden Securities Corporation	Dallas, TX
V. Keith Roberts	Stanford Group Company	Houston, TX
David W. Turner	Wachovia Securities, Inc.	Fort Worth, TX

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**District 7**

Daniel J. Stefak, District Director

One Securities Centre, Suite 500, 3490 Piedmont Road, NE, Atlanta, GA 30305

(404) 239-6100

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

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**District 7 Committee Incoming Members**

Erick R. Holt, Esq.	AMVESCAP	Atlanta, GA
William G. McMaster	Scott & Stringfellow, Inc.	Columbia, SC
Charles F. O'Kelley	Atlantic Coast Securities Corporation	Tampa, FL

**District 7 Nominating Committee Incoming Members**

Jeffrey P. Adams	Balentine & Company	Atlanta, GA
Richard G. Averitt, III	Raymond James Financial Services, Inc.	St. Petersburg, FL
Richard V. McGalliard	Wachovia Securities, Inc.	Atlanta, GA
Kenneth W. McGrath	Popular Securities, Inc.	Hato Rey, Puerto Rico
Robert A. Young	Young, Stovall & Company	Miami, FL

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## District 8

Carlotta A. Romano, District Director

55 West Monroe Street, Suite 2700, Chicago, IL 60603-5052

(312) 899-4400

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

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### District 8 Committee Incoming Members

Richard M. Arceci	ValMark Securities, Inc.	Akron, OH
Ronald J. Dieckman	J.J.B. Hilliard, W.L. Lyons, Inc.	Louisville, KY
Julie E. Vander Weele	Mesirow Financial, Inc.	Chicago, IL

### District 8 Nominating Committee Incoming Members

Bernard A. Breton	Carillon Investments, Inc.	Cincinnati, OH
William K. Curtis	M & I Brokerage Service, Inc.	Milwaukee, WI
Carol P. Foley	Podesta & Company	Chicago, IL
Gregory Goelzer	Goelzer Investment Management	Indianapolis, IN
Bruce J. Young	Mesirow Financial, Inc.	Chicago, IL

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**District 9**

**Gary K. Liebowitz**, District Director

581 Main Street, 7th Floor  
Woodbridge, NJ 07095

(732) 596-2000

**John P. Nocella**, District Director

Eleven Penn Center, 1835 Market Street  
19th Floor, Philadelphia, PA 19103

(215) 665-1180

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*New Jersey and New York (except for  
the counties of Nassau and Suffolk, and  
the five boroughs of New York City)*

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

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**District 9 Committee Incoming Members**

<b>Scott L. Fagin</b>	The Jeffrey Matthews Financial Group, L.L.C.	Millburn, NJ
<b>Rebecca L. Kohler</b>	American Express Financial Advisors Inc.	Roanoke, VA
<b>Jerome J. Murphy</b> <i>(1-Year Term)</i>	Janney Montgomery Scott LLC	Philadelphia, PA
<b>Harold N. Peremel</b> <i>(2-Year Term)</i>	Peremel & Co., Inc.	Baltimore, MD
<b>Dorothy G. Sanders</b>	Fred Alger & Company, Incorporated	Jersey City, NJ

**District 9 Nominating Committee Incoming Members**

<b>James E. Bickley</b>	Cresap, Inc.	Horsham, PA
<b>J. Lee Keiger, III</b>	Davenport & Company, LLC	Richmond, VA
<b>Michael S. Mortensen</b>	PNC Investments	Pittsburgh, PA
<b>Michael B. Row</b>	Pershing, LLC	Jersey City, NJ
<b>Howard B. Scherer</b>	Janney Montgomery Scott LLC	Philadelphia, PA

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**District 10**

Hans Reich, Regional Director, New York Region

One Liberty Plaza, New York, NY 10006

(212) 858-4000

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*New York (the counties of Nassau and Suffolk, and the five boroughs of New York City)*

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**District 10 Committee Incoming Members**

To Be Announced

**District 10 Nominating Committee Incoming Members**

William Behrens	Northeast Securities, Inc.	New York, NY
Jennifer A. Connors	ITG Inc.	New York, NY
Ruth S. Goodstein	UBS Financial Services, Inc.	New York, NY
Mark Ronda	Oppenheimer & Co., Inc.	New York, NY
Charles V. Senatore	Fidelity Brokerage Services, LLC	New York, NY

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## District 11

Frederick F. McDonald, District Director

99 High Street, Suite 900, Boston, MA 02110

(617) 532-3400

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

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### District 11 Committee Incoming Members

Frank L. Chandler	Boston Capital Services, Inc.	Boston, MA
Joseph Gritzer	USI Securities, Inc.	Glastonbury, CT
Moira Lowe	Tower Square Securities, Inc.	Hartford, CT
Wilson G. Saville <i>(1-Year Term)</i>	Barrett & Company	Providence, RI

### District 11 Nominating Committee Incoming Members

Michael C. Braun	Moors & Cabot, Inc.	Boston, MA
Andrew F. Detwiler	Vandham Securities Corp.	Boston, MA
John I. Fitzgerald	Leerink Swann & Company	Boston, MA
Thomas J. Horack	John Hancock Life Insurance Company	Boston, MA
Gregory D. Teese	Equity Services, Inc.	Montpelier, VT

# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Fairness Opinions  
Investment Banks  
Mergers and Acquisitions  
Proxy Statements

## REQUEST FOR COMMENT

### Fairness Opinions Issued by Members

NASD Requests Comment on Whether to Propose New Rule That Would Address Conflicts of Interest When Members Provide Fairness Opinions in Corporate Control Transactions; **Comment Period Expires January 10, 2005**

#### Executive Summary

NASD is requesting comment on whether it should propose a new rule that would address procedures, disclosure requirements, and conflicts of interest when members provide fairness opinions in corporate control transactions. A fairness opinion addresses the fairness, from a financial point of view, of the consideration involved in a transaction. Investment banks typically provide fairness opinions in corporate control transactions, including mergers and acquisitions, the disposition or divestiture of material assets, divisions or subsidiaries, and buybacks of outstanding securities ("transactions"). The scope of the investment bank's involvement typically is set out in an engagement letter between the bank and the company.

Investment banks that render fairness opinions may be influenced by whether the company's management supports the transaction. In other words, the investment bank may find that the transaction is fair from a financial viewpoint if the transaction is favored by the company's management, and, alternatively, opine that the financial terms are not fair if management opposes the transaction. This conflict may be especially strong when a transaction that is supported by management is also one in which the investment bank acted as the financial advisor to the company in recommending or structuring the transaction and/or where the investment bank will receive financial advisory fees upon successful completion of the transaction.

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NASD is considering whether to propose a new rule that would require members to: (1) disclose in any fairness opinion appearing in any proxy statement any significant conflicts of interest, including, if applicable, that the member has served as an advisor on the transaction in question, and the nature of compensation that the member will receive upon the successful completion of the transaction; and (2) require specific procedures that members must follow to identify and disclose potential conflicts of interest in rendering fairness opinions.

### Questions/Further Information

Questions concerning this *Notice* should be directed to Joseph E. Price, Vice President, Corporate Financing, at (240) 386-4623; or Gary L. Goldsholle, Associate Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8104.

### Action Requested

NASD encourages all interested parties to comment on the proposed rule. Comments must be received by **January 10, 2005**. Members and other interested parties can submit their comments using the following methods:

- ◆ mailing in written comments; or
- ◆ e-mailing written comments to [pubcom@nasd.com](mailto:pubcom@nasd.com).

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>1</sup>

Before becoming effective, a proposed rule change must be authorized for filing with the Securities and Exchange Commission (SEC) and by the NASD Board, and then must be approved by the SEC, following publication for public comment in the *Federal Register*.<sup>2</sup>

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## Background and Discussion

Although fairness opinions are not required by any statute or regulation, they have become a regular feature of corporate control transactions since 1985, when the Delaware Supreme Court found that a corporate board breached its fiduciary duty of care by approving a merger without adequate information on the transaction, including information on the value of the company and the fairness of the offering price.<sup>3</sup>

Fairness opinions assist directors in fulfilling their fiduciary obligations. Under the business judgment rule, a corporate board of directors is protected from liability to a company's shareholders for decisions made in good faith, in an informed manner and on a rational basis. A number of courts have held that directors can fulfill their fiduciary duty of care by relying in good faith on fairness opinions.<sup>4</sup> Fairness opinions typically provide that the opinion is for the use and benefit of the board of directors, but the opinions are disclosed in various SEC forms and investors often refer to them.<sup>5</sup>

The SEC's proxy rules require that when a company's board of directors obtains a fairness opinion that is referred to in the proxy statement, the opinion must be fairly summarized and describe:

- ◆ the procedures followed;
- ◆ findings and recommendations;
- ◆ bases for and methods of arriving at such findings and recommendations;
- ◆ any instruction received from the subject company concerning the investigation; and
- ◆ any limitation imposed by the subject company on the scope of the investigation.<sup>6</sup>

Fairness opinions typically disclose that in preparing the opinion, the investment bank has assumed and relied on the accuracy and completeness of all information made available to the investment bank by the company and the investment bank has not assumed any responsibility to independently verify such information or undertaken an independent appraisal of the assets or liabilities of the company.

Notwithstanding the proxy statement disclosure requirements, NASD is concerned that these disclosures may not sufficiently inform investors about the subjective nature of some opinions and their potential biases.

In addition, the multiplicity of valuation methodologies employed, the sensitivity of results to small changes in the underlying assumptions, and a perceived tendency to make judgment calls that support the company managers' preferred outcome have been the subject of criticism.<sup>7</sup>

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Finally, when the transaction will result in one group of shareholders, a Board member, or employee receiving a benefit or payout that is materially different than that received by the unaffiliated shareholders, this result may create biases in favor of the transaction if the people receiving the benefit were involved in hiring the investment bank or are in the position to direct future business to the investment bank.

NASD requests comment on the best way to improve the processes by which investment banks render fairness opinions and manage the inherent conflicts.

In particular, NASD requests comment on whether it should propose a new rule to regulate the identification and disclosure of conflicts by members that provide fairness opinions in corporate control transactions. Such a rule could require a member to provide in any fairness opinion that will be included in a proxy statement a clear and complete description of any significant conflict of interest by the member, including, if applicable, that the member has served as an advisor on the transaction in question and the nature of compensation that the member will receive upon the successful completion of the transaction (including any variance or contingency in the fee charged for the fairness opinion). Such a rule also could require a member to disclose the extent to which the firm relied on key information supplied by a company or its management, or whether it independently verified certain information.

In addition, the new rule could set forth specific procedures that members must follow to guard against conflicts of interest in rendering fairness opinions. Such procedures also could address the substantive factors used by members in reaching a fairness opinion. These procedures could address:

- ▶ the process by which fairness opinions are approved by a firm, including whether the firm uses a fairness committee, and, if so, the selection of personnel for the fairness committee, the level of experience of such persons, procedures designed to provide balanced review, and whether steps have been taken to require review by persons whose compensation is not directly related to the underlying transaction of the fairness opinion;
- ▶ the process to determine whether the valuation analyses used are appropriate for the type of transaction and the type of companies that propose to participate in the transaction; and
- ▶ the process to evaluate the degree to which the amount and nature of the compensation from the transaction underlying the fairness opinion benefits any individual officers, directors or employees, or class of such persons, relative to the benefits to shareholders of the company, is a factor in reaching a fairness determination.

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## Endnotes

- 1 See *Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments). Personal identifying information, such as names or email addresses, will not be edited from submissions. Persons commenting on this proposal should submit only information that they wish to make publicly available.
- 2 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.
- 3 See *Smith v. Van Gorkum*, 488 A. 2d 858 (Del. 1985). However, neither the Van Gorkum court nor subsequent Delaware case law requires a corporation's board to procure a fairness opinion in connection with its duty to consider necessary information, including valuation, pertaining to a corporate control transaction.
- 4 See, e.g., *Treadway Cos. v. Care Corp.*, 638 F.2d 357 (2d Cir. 1980).
- 5 SEC Rule 13e-3 requires the issuer or affiliate engaging in the going-private transactions to state whether it believes the transaction is fair to the unaffiliated security holders and to disclose any fairness opinion prepared by an investment bank. See also Item 14(b)(6) of SEC Schedule 14A, Item 4(b) of SEC Form S-4, and Item 1015 of SEC Regulation M-A.
- 6 Item 1015(b)(6) of SEC Regulation M-A.
- 7 See, e.g., David Henry, *A Fair Deal - But For Whom?*, Business Week Online, Nov. 24, 2003; Elson, Rosenbloom and Chapman, *Fairness Opinions - Can They be Made Useful?*, 35 Securities Regulation & Law 46, Nov. 24, 2003, at p. 1984.

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# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Legal and Compliance  
Operations Managers  
Senior Management

## KEY TOPICS

Section 1 of Schedule A to NASD By-Laws  
Trading Activity Fee

## GUIDANCE

### Guidance on the Trading Activity Fee

#### SEC Approves Adjustments to the Trading Activity Fee

#### Executive Summary

On October 1, 2004, the Securities and Exchange Commission (SEC or Commission) approved an NASD rule filing amending the Trading Activity Fee (TAF) to reduce the TAF rate for covered equity securities, reduce the maximum per trade charge on covered equity securities, and assess the TAF on corporate debt securities that, under the Trade Reporting and Compliance Engine (TRACE) rules, are defined as "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and all municipal securities subject to Municipal Securities Rulemaking Board (MSRB) reporting requirements.<sup>1</sup> NASD will implement these changes as follows: (1) the TAF rate reduction and the reduction on the maximum per trade charge on covered equity securities will be effective November 1, 2004; and (2) the TAF will be assessed on "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and all municipal securities subject to MSRB reporting requirements effective April 1, 2005. NASD is delaying the effective date for debt securities until April 1 to allow member firms sufficient time to make programming changes to reflect the addition of two new categories of covered securities.

In this *Notice*, NASD is providing additional guidance with respect to certain equity security transactions and is seeking information from member firms concerning interpretive issues with respect to the operational aspects of applying the TAF to debt securities. NASD requests that members' interpretive questions be submitted in writing to NASD by no later than **January 1, 2005** so that NASD can provide the necessary guidance to ensure members are able to program their systems for debt securities by the April 1, 2005 effective date.

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Included with the *Notice* is Attachment A, the text of the amendments to Schedule A to the NASD By-Laws and Attachment B, the revised form indicating the new equity rates.

## Questions/Further Information

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

## Background and Discussion

On December 29, 2003, NASD filed with the Commission a proposed rule change to adjust the TAF rate for covered equity securities, reduce the maximum per trade charge on covered equity securities, and assess the TAF on corporate debt securities that, under the TRACE rules, are defined as "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and on municipal securities subject to MSRB reporting requirements. The proposed rule change was published for notice and comment in the *Federal Register* on January 28, 2004.<sup>2</sup> On May 19, 2004, NASD filed with the Commission Amendment No. 1 and, at the same time, responded to comments submitted on the proposal. On September 30, 2004, NASD responded to further comments. The SEC approved the proposed rule change on October 1, 2004.

NASD is proceeding with its commitment to ensure that its new member regulatory structure, as approved by the SEC,<sup>3</sup> remains revenue neutral to NASD and better aligns NASD's regulatory fees with its functions, efforts, and costs. As stated in the NASD By-Laws, NASD will analyze rates, volumes, and regulatory responsibilities periodically to sustain adequate funding levels for its member regulatory programs.<sup>4</sup> Further, as part of a three-year phase-in plan included in the originally proposed pricing structure, NASD intends to reduce the revenue from the collection of the TAF by approximately 50 percent over the three-year period, offset by an increase in the Personnel Assessment. Thus, with this rule change, NASD is reducing the TAF rate on covered equity securities from the current rate of \$0.10 per 1,000 shares to \$0.075 per 1,000 shares.<sup>5</sup> In addition, the maximum charge per trade under the TAF is being reduced from the current cap of \$10 per trade (based on 100,000 shares) to \$3.75 per trade (based on 50,000 shares).

Further, in response to previous comments from a number of members and other self-regulatory organizations about the scope of the TAF, NASD committed to analyzing whether debt transactions should be included under the TAF. NASD has reviewed reported volumes for TRACE-eligible securities and municipal securities in conjunction with NASD's current regulatory costs associated with the oversight of these securities. Based upon this review, NASD is assessing the TAF on TRACE-eligible securities and municipal securities at a rate of \$0.00075 per bond, with a maximum assessment of \$0.75 per trade (based on 1,000 bonds).

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### **Implementation Date**

NASD implemented the TAF rate reduction and the reduction on the maximum per trade charge on covered equity securities on November 1, 2004. In addition, NASD will begin assessing the TAF on "TRACE-eligible securities" that fall within the definition of a "reportable TRACE transaction" (as defined in Rule 6210) and all municipal securities subject to MSRB reporting beginning on April 1, 2005. NASD is designating an effective date six months after SEC approval to allow member firms sufficient time to make programming changes to reflect the addition of two new categories of covered securities.

### **Guidance Regarding Certain Equity Transactions**

NASD assesses the TAF on its members through clearing and self-clearing firms. As NASD stated in *Notice to Members 02-75*, the TAF is not assessed on transactions for non-member broker-dealers that clear through an NASD member unless that NASD member clearing firm is acting as executing broker in the transaction. NASD further stated in *Notice to Members 03-30* that NASD would consider a clearing firm to be acting as an executing broker if its correspondents utilized the clearing firm's order delivery system to send and execute orders under the clearing firm's MPID. NASD has received numerous questions concerning the application of this interpretation, particularly when the non-member broker-dealer does not use the clearing firm's system to route the order to another market center for execution. To further clarify, NASD considers the NASD member clearing firm to be the executing broker in any transaction where its non-member broker-dealer correspondent is only able to effect the trade by virtue of its clearing firm's membership with the applicable market center. For example, trades reported to ACT generally must be submitted to ACT by an NASD member. Therefore, the non-member correspondent would not be able to effect trades required to be reported to ACT without the use of the clearing firm's MPID that is granted to the clearing firm based on its NASD membership. Further, because the TAF is assessed on all covered securities transactions wherever executed, this interpretation also applies to similarly structured transactions effected on a national securities exchange.

### **Solicitation of Interpretive Questions Relating to Assessing the TAF on Debt**

NASD encourages all interested parties to submit interpretive questions relating to the operational aspects of assessing the TAF on debt securities. Members have stated that there are certain operational issues that must be addressed with respect to assessing the TAF on debt securities prior to programming. While the TAF will be applied to debt in generally the same manner as covered equity securities, NASD recognizes that there may be certain issues unique to debt. To ensure all potential questions regarding differences in the application of the TAF between debt and equity securities are

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adequately addressed, NASD is seeking to receive a comprehensive list of all such issues from industry participants. Questions must be received by NASD by **January 1, 2005**. Members and other interested parties can submit their questions using the following methods:

- ◆ Mailing the questions in hard copy to the address below; or
- ◆ E-mailing the questions to *pubcom@nasd.com*.

To help NASD process and review the questions more efficiently, persons submitting questions should use only one method. Questions 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

NASD staff will compile a list of those questions it believes will assist industry participants in complying with the amendments and publish these questions and answers in a subsequent *Notice to Members*.

## Endnotes

- 1 Securities Exchange Act Rel. No. 50485 (Oct. 1, 2004), 69 FR 60445 (Oct. 8, 2004) (File No. SR-NASD-2003-201) (Order of Approval).
- 2 Securities Exchange Act Rel. No. 49114 (Jan. 22, 2004), 69 FR 4194 (Jan. 28, 2004) (Notice of Filing of Proposed Rule Change).
- 3 Securities Exchange Act Rel. No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (approving SR-NASD-2002-148) and Securities Exchange Act Rel. No. 47106 (Dec. 30, 2002), 68 FR 819 (Jan. 7, 2003) (approving SR-NASD-2002-99).
- 4 Specifically, NASD stated in the text of the TAF rule that it will “periodically review these revenues in conjunction with these costs to determine the applicable rate.” NASD By-Laws, Schedule A, Section 1(a).
- 5 NASD also will seek to reduce the TAF rate in 2005, if appropriate, after analyzing all relevant factors.
- 6 See question 6 in *Notice to Members 02-75*.
- 7 See question 3 in *Notice to Members 03-30*.

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## ATTACHMENT A

Text of Rule Change

New language is underlined; deleted language is in brackets.

\* \* \* \* \*

### Schedule A to NASD By-Laws

\* \* \* \* \*

#### Section 1 -- Member Regulatory Fees

- (a) No Change.
- (b) Each member shall be assessed a Trading Activity Fee for the sale of covered securities.
  - (1) Covered Securities. For purposes of the rule, covered securities shall mean:
    - (A) All exchange registered securities wherever executed ([other than bonds, debentures, and other evidence of indebtedness]except debt securities that are not TRACE-eligible securities);
    - (B) All other equity securities traded otherwise than on an exchange; [and]
    - (C) All security futures wherever executed[.];
    - (D) All "TRACE-eligible securities" wherever executed, provided that the transaction also is a "reportable TRACE transaction," as these terms are defined in Rule 6210; and
    - (E) All municipal securities subject to MSRB reporting requirements.
  - (2) Transactions exempt from the fee. The following shall be exempt from the Trading Activity Fee:
    - (A) No Change.
    - (B) Transactions by an issuer not involving any public offering within the meaning of Section 4(2) of the Securities Act of 1933 (except any "reportable TRACE transaction").
    - (C) through (I) No Change.

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(J) Transactions in security futures held in futures accounts; [and]

(K) Transactions in exchange listed options effected by a member when NASD is not the designated options examining authority for that member[.]; and

(L) Proprietary transactions in TRACE-eligible securities by a firm that is a member of both NASD and a national securities exchange and that are effected in the firm's capacity as an exchange specialist or exchange market maker.

NASD may exempt other securities and transactions as it deems appropriate.

(3) Fee Rates\*

(A) through (C) No Change.

(D) Each member shall pay to NASD a fee per bond for each sale of a covered TRACE-eligible security and/or municipal security.

\* Trading Activity Fee rates are as follows: Each member shall pay to NASD [~~\$0.0001~~]\$0.000075 per share for each sale of a covered equity security, with a maximum charge of [~~\$10~~]\$3.75 per trade; \$0.002 per contract for each sale of an option; [and] \$0.04 per contract for each round turn transaction of a security future; and \$.00075 per bond for each sale of a covered TRACE-eligible and/or municipal security, with a maximum charge of \$0.75 per trade. In addition, if the execution price for a covered security is less than the Trading Activity Fee rate (~~[\$0.0001]~~\$0.000075 for covered equity securities, \$0.002 for covered option contracts, or \$0.04 for a security future) on a per share, per contract, or round turn transaction basis, then no fee will be assessed.

(4) Reporting of Transactions. Members shall report to NASD the aggregate share, bond, contract, and/or round turn volume of sales of covered securities in a manner as prescribed by NASD from time to time.

(c) through (d) No Change.



# Trading Activity Fee Self-Reporting Form

(Effective November 1, 2004)

Firm Name: \_\_\_\_\_

Mailing Address: \_\_\_\_\_

Check If New Address

B/D#: \_\_\_\_\_

Clearing#: \_\_\_\_\_

For the Month of: \_\_\_\_\_

Each member shall report sales of covered securities pursuant to the provisions of Section 2(b) [Trading Activity Fee] of Schedule A, Section 2 [Member Regulation Fees] to NASD's By-Laws. Covered securities include: 1) all exchange registered securities wherever executed (other than bonds, debentures, and other evidence of indebtedness), 2) all other equity securities traded otherwise than on an exchange, and 3) all security futures wherever executed.

Transaction Type	Aggregate Volume	Rate	Assessment Amount
1. Covered Equity Securities (under maximum <sup>1</sup> ) - # of Shares	_____	\$0.000075	_____
2. Covered Equity Securities at maximum <sup>1</sup> ) - # of Trades	_____	\$3.75	_____
3. Covered Option Contracts	_____	\$0.002	_____
4. Covered Future Securities (# of Contracts Traded on a Round Turn Basis)	_____	\$0.04	_____
<b>Total Assessment</b>			_____

Signature of Authorized Representative \_\_\_\_\_ Title \_\_\_\_\_

Print Name \_\_\_\_\_ Date/Telephone Number \_\_\_\_\_

E-Mail Address \_\_\_\_\_

Payment must be submitted with this form. The monthly form and payment are to be filed no later than 10 business days following the end of the month. The monthly form and payment may be submitted to NASD by either US mail or overnight Express mail as follows:

**For U.S. mail delivery:**

NASD  
P.O. Box 7777-W8555  
Philadelphia, PA 19175-8555  
Note: This P.O. Box will not accept courier or overnight deliveries.

**For courier & overnight deliveries:**

NASD  
W8555 c/o Mellon Bank, Rm 3490  
Philadelphia, PA 19106  
Phone number: 215-553-0697 (if required for the recipient)

If other payment methods are required, please call NASD Finance, at (240) 386-5394. Questions regarding the Trading Activity Fee or the report should be directed to NASD Finance, at (240) 386-5397.

1 There is a \$3.75 maximum on covered equity securities. All volumes under the maximum of 50,000 shares must be reported as the aggregate number of shares on Line 1. Share volume for any transactions of 50,000 shares or more should be excluded from Line 1 and would be reported as the aggregate number of trades on Line 2.

# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Internal Audit  
Legal & Compliance  
Operations  
Senior Management  
Systems  
Trading

## KEY TOPICS

OATS  
Rule 6954(c)

## GUIDANCE

### OATS Reporting Requirements

SEC Approves Amendments to Rule 6954(c) Requiring ECNs to Capture and Report Routed Order Identifier Information to OATS; **Effective Date: February 14, 2005**

#### Executive Summary

On September 17, 2004, the Securities and Exchange Commission (SEC) approved amendments to Rule 6954(c) to require that electronic communication networks (ECNs) that electronically receive routed orders capture and report the transmitting member's unique identifier (routed order identifier) to the Order Audit Trail System (OATS).<sup>1</sup> Rule 6954(c), as amended, is set forth in Attachment A. The amendments become effective on **February 14, 2005**.

#### Questions/Further Information

Questions regarding this *Notice* may be directed to the Legal Section, Market Regulation, at (240) 386-5126; or the Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8071. For technical questions regarding OATS Reporting, please contact the OATS Help Desk at (800) 321-NASD.

#### Background and Discussion

On March 6, 1998, the SEC approved NASD Rules 6950 through 6957 (the OATS Rules).<sup>2</sup> OATS provides comprehensive information regarding orders and transactions that is critical to NASD staff in conducting surveillance and investigations of member firms for potential violations of NASD rules and the federal securities laws.

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The use of a routed order identifier reported through OATS permits NASD to track the history of orders routed between firms on an automated basis. If the order does not contain a routed order identifier, the order cannot be linked on an automated basis to subsequent actions, such as further routing or execution by other firms or NASDAQ systems. OATS Rules previously did not require that ECNs capture routed order identifier information for orders routed electronically to them. Given the current level of participation of ECNs in the trading of NASDAQ securities, the lack of a routed order identifier for these electronic orders results in NASD staff having to recreate manually the lifecycle history for a substantial number of orders.

Accordingly, the new amendments require that ECNs that electronically receive routed orders capture and report the routed order identifier to OATS. The amendments will be effective on February 14, 2005. As such, OATS will reject any OATS Order Reports submitted after February 14, 2005 without the required information. More detailed information on these new requirements, including the technical requirements for submission of the new fields, will be provided in the OATS Reporting Technical Specifications, which are available on NASD's Web site at *Regulatory Systems > OATS > Technical Specifications*.

## Endnotes

- 1 See Securities Exchange Act Release No. 50409 (September 17, 2004), 69 FR 184 (September 23, 2004) (File No. SR-NASD-2004-137) (SEC Approval Order).
- 2 See *Notice to Members 98-33* (March 1998) for a complete description of the OATS Rules.

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### 6954. Recording of Order Information

(a) and (b) No Change.

(c) Order Transmittal

Order information required to be recorded under this Rule when an order is transmitted includes the following.

(1) and (2) No Change.

(3) When a member electronically transmits an order for execution on an Electronic Communications Network:

(A) No Change.

(B) the receiving Reporting Member operating the Electronic Communications Network shall record:

(i) the fact that the order was received by an Electronic Communications Network,

(ii) the order identifier assigned to the order by the member that transmits the order,

~~(iii)~~ [(ii)] the market participant symbol assigned by the Association to the transmitting Reporting Member, and

(iv) [(iii)] other information items in Rule 6954(b) that apply with respect to such order, which must include information items (1), (2), (3), (6), (7), (8), (10), (11), (12), (13), (15), and (16).

(4) through (6) No Change.

(d) No Change.

# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Executive Representatives  
Legal & Compliance  
Senior Management

## KEY TOPICS

IM-2210-6  
Investment Analysis Tools  
Predictions or Projections

## GUIDANCE

### Investment Analysis Tools

SEC approves NASD Interpretive Material to Rule 2210 regarding member firms' use of investment analysis tools; **Effective Date: February 14, 2005**

#### Executive Summary

On September 28, 2004, the Securities and Exchange Commission (SEC) approved an NASD Interpretive Material (IM) to Rule 2210, designated as IM-2210-6, regarding "investment analysis tools."<sup>1</sup> IM-2210-6 will allow members to use and provide customers access to investment analysis tools if the members comply with certain disclosure and other requirements. The new rule text is contained in Attachment A and is effective on **February 14, 2005**.

#### Questions/Further Information

Questions regarding this *Notice* may be directed to Thomas M. Selman, Senior Vice President, Advertising Regulation Department (Advertising Department), Regulatory Policy and Oversight (RPO), at (240) 386-4533; Thomas A. Pappas, Associate Vice President, Advertising Department, RPO, at (240) 386-4553; or James S. Wrona, Associate General Counsel, Office of General Counsel, RPO, at (202) 728-8270.

#### Background

In recent years, the public increasingly has sought access to additional sources of investment information and tools to make investment decisions. Technology has been a key component of members' attempts to meet this investor demand. NASD Rule 2210(d)(1)(D), however, prohibits members from making predictions or projections regarding investments or investment strategies.<sup>2</sup> This

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prohibition, in turn, precluded member firms from offering investors technological tools that used a mathematical formula to calculate the probability that investment outcomes (such as reaching a financial goal) would occur. As part of its rule modernization project, NASD proposed IM-2210-6 as a limited exception to the general prohibition on predictions and projections in Rule 2210(d)(1)(D) to allow members to offer such technological tools under certain circumstances.<sup>3</sup> On September 28, 2004, the SEC approved the proposal.<sup>4</sup> IM-2210-6 becomes effective on **February 14, 2005**.

With this change, members that comply with the disclosure and other requirements of IM-2210-6 will be permitted to offer customers the use of investment analysis tools.<sup>5</sup> IM-2210-6 defines an investment analysis tool as “an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices.” Members also will be permitted to provide customers with written reports generated by and sales material concerning investment analysis tools.

Pursuant to IM-2210-6, a member may offer an investment analysis tool (whether customers use the member’s investment analysis tool independently or with assistance from the member), written reports indicating the results generated by such tool and related sales material only if the member:

- ▶ Describes the criteria and methodology used, including the investment analysis tool’s limitations and key assumptions.
- ▶ Explains that results may vary with each use and over time.
- ▶ Describes, if applicable, the universe of investments considered in the analysis; explains how the tool determines which securities to select; discloses if the tool favors certain securities and, if so, explains the reason for the selectivity; and states that other investments not considered may have characteristics similar or superior to those being analyzed.
- ▶ Displays the following additional disclosure: “IMPORTANT: The projections or other information generated by [name of investment analysis tool] regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results.”

These disclosures must be clear and prominent and must be in written (electronic or hard copy) narrative form.<sup>6</sup> In addition, a member that offers or intends to offer an investment analysis tool, written report, or related sales material under IM-2210-6 must, *within 10 days of first use*, (1) provide the Advertising Department access to the investment analysis tool and (2) file with the Advertising Department any template for written reports produced by, and sales material concerning, the tool.<sup>7</sup> Moreover, after the Advertising Department has reviewed the investment analysis tool, written-report template or sales material, a member must notify the Advertising Department and provide additional access to the tool and re-file any template and sales material if the member makes a *material change* to the presentation of information or disclosures.

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If a member is already using an investment analysis tool that falls within the rule's coverage, and the member has not previously filed this tool with the Advertising Department, the member must file the tool, any written-report template generated by the tool, and sales material for the tool within 10 days of the effectiveness of IM-2210-6. In addition, even if a member previously filed an investment analysis tool with the Advertising Department, the member must re-file the tool, written-report template and sales material within 10 days of the effectiveness of IM-2210-6, so that the Advertising Department can ensure that the member has met the rule's requirements.

The filing requirement does not apply to hypothetical illustrations of mathematical principles that do not predict or project the performance of an investment or investment strategy, such as Web site calculators that compute future returns based upon assumed variables, since Rule 2210(d)(1)(D) does not prohibit (and IM-2210-6 thus does not cover) such illustrations.<sup>8</sup> In addition, a member that offers an investment analysis tool exclusively to "institutional investors," as defined in Rule 2211(a)(3), is not subject to the filing requirements discussed above if the communications relating to or produced by the tool meet the criteria for "institutional sales material," as defined in Rule 2211(a)(2).<sup>9</sup> Furthermore, sales material that contains only an incidental reference to an investment analysis tool (e.g., a brochure that merely mentions a member's tool as one of the services offered by the member) need not include the disclosures required by IM-2210-6 and would not need to be filed with the Advertising Department, unless otherwise required by the other provisions of Rule 2210. However, any description of the tool or its features will trigger application of the disclosure and filing requirements of IM-2210-6.

Members must keep in mind that compliance with IM-2210-6 does not mean that the member is acting in conformity with other applicable laws and rules. A member that offers an investment analysis tool under IM-2210-6 (whether customers use the member's investment analysis tool independently or with assistance from the member) is responsible for ensuring that use of the tool and all recommendations based on the tool (whether made via the automated tool or a written report) comply with the federal securities laws, NASD rules and SEC rules, including, but not limited to, as applicable, the following:

- ▶ NASD's suitability rule (Rule 2310).
- ▶ The other provisions of Rule 2210 (including the principles of fair dealing and good faith; the prohibition on exaggerated, unwarranted or misleading statements or claims; and any other applicable filing requirements for advertisements and sales literature).
- ▶ SEC rules (including SEC Rule 156 under the Securities Act of 1933).

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## Endnotes

1. See SEC Order Approving NASD New Interpretive Material to Rule 2210 Regarding Investment Analysis Tools (SEC Order Regarding Investment Analysis Tools), Exchange Act Rel. No. 50463 (Sept. 28, 2004), 69 FR 60200 (Oct. 7, 2004) (SR-NASD-2003-13).
2. Rule 2210(d)(1)(D) states:

Communications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast. A hypothetical illustration of mathematical principles is permitted, provided that it does not predict or project the performance of an investment or investment strategy.
3. Rule 2210(d)(1)(D), by its explicit language, does not prohibit (and IM-2210-6 thus does not cover) certain hypothetical illustrations of mathematical principles that do not predict or project the performance of an investment or investment strategy. The "hypothetical illustration" exception to the prohibition in Rule 2210(d)(1)(D) applies to tools that serve the function of a calculator that computes the mathematical outcome of certain assumed variables without predicting the likelihood of either the assumed variables or the outcome. For example, this exception would apply to a calculator that computes a net amount of savings that an investor would earn over an assumed period of time with assumed variables of rates of returns, frequency of compounding, and tax rates. On the other hand, this exception would not apply to a calculator that predicted the likelihood of achieving these assumed variables and outcomes.
4. During the rulemaking process, NASD modified the original proposal to accommodate a number of commenters' concerns submitted in response to the public comment notification in the *Federal Register*. See SEC Order Regarding Investment Analysis Tools, Exchange Act Rel. No. 50463, 69 FR 60200, at 60203-60204 (discussing NASD's response to comments and modifications to original proposal).
5. For guidance on whether a member must comply with IM-2210-6 regarding a hyperlink to an affiliated or unaffiliated Web site that offers an investment analysis tool, see NASD *Interpretive Letter, Response to Recommendations of the Investment Company Institute Concerning Hyperlinks* (Nov. 11, 1997) (discussing members' responsibilities for content and filing requirements for ongoing hyperlinks to Web sites created by independent parties). If a member is responsible for the information on the hyperlinked Web site under the analyses discussed in the November 1997 Interpretive Letter, the member must either comply with IM-2210-6 or discontinue the hyperlink.
6. Although each required disclosure need not be displayed on every separate Web page and/or page of a written report generated by the tool, the disclosures must be "clear and prominent" in light of the content, context, and presentation of the tool and/or written report. In addition, if the member provides customers access to an investment analysis tool and written report generated by the tool, the disclosures must be clear and prominent on both the tool and the written report. A member may not provide clear and prominent disclosures on one but not the other. For instance, a member cannot simply refer in a written report to the disclosures made by the tool (and vice versa).

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7. The Advertising Department's review of investment analysis tools generally will focus on whether the member has made the proper disclosures. Members are cautioned that they may not imply that NASD endorses or approves the use of any investment analysis tool or any recommendation based on such a tool.
  8. See *supra* note 3 and accompanying discussion.
  9. If a member presents an investment analysis tool on its Web site and non-institutional customers can access and use the tool, the member must comply with the filing requirements. This would be true even if the member indicated on its Web site that only institutional customers should use the tool. Moreover, members should note that, even if the investment analysis tool were offered exclusively to institutional customers, the member still would have to adhere to the disclosure requirements and would retain suitability obligations to the extent they arise in connection with the use of the investment analysis tool by such institutional customers.

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## ATTACHMENT A

### Text of Rule Change

New language is underlined.

\* \* \* \* \*

#### **IM-2210-6. Requirements for the Use of Investment Analysis Tools**

##### **(a) General Considerations**

This Interpretive Material provides a limited exception to NASD Rule 2210(d)(1)(D).<sup>1</sup> No member may imply that NASD endorses or approves the use of any investment analysis tool or any recommendation based on such a tool. A member that offers or intends to offer an investment analysis tool under this Interpretive Material (whether customers use the member's tool independently or with assistance from the member) must, within 10 days of first use, (1) provide NASD's Advertising Regulation Department (Department) access to the investment analysis tool and (2) file with the Department any template for written reports produced by, or sales material concerning, the tool.<sup>2</sup> The member also must provide any supplemental information requested by the Department. The Department may require that the member modify the investment analysis tool, written-report template or sales material. The Department also may require that the member not offer or continue to offer or use the tool, written-report template or sales material until all changes specified by the Department have been made by the member.

A member that offers an investment analysis tool exclusively to "institutional investors," as defined in Rule 2211(a)(3), is not subject to the post-use access and filing requirement in this paragraph if the communications relating to or produced by the tool meet the criteria for "institutional sales material," as defined in Rule 2211(a)(2). A member that intends to make the tool available to, or that intends to use the tool with, any person other than an institutional investor (such as an employee benefit plan participant or a retail broker-dealer customer) will be subject to the filing and access requirements, however.

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1 NASD Rule 2210(d)(1)(D) states that "[c]ommunications with the public may not predict or project performance, imply that past performance will recur or make any exaggerated or unwarranted claim, opinion or forecast." This Interpretive Material allows member firms to offer investment analysis tools (whether customers use the member's tool independently or with assistance from the member), written reports indicating the results generated by such tools and related sales material in certain circumstances.

Rule 2210(d)(1)(D) does not prohibit, and this Interpretive Material does not apply to, hypothetical illustrations of mathematical principles that do not predict or project the performance of an investment or investment strategy.

2 After the Department has reviewed the investment analysis tool, written-report template or sales material, a member must notify the Department and provide additional access to the tool and re-file any template or sales material if it makes a material change to the presentation of information or disclosures as required by paragraphs (c) and (d).

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As in all cases, a member's compliance with this Interpretive Material does not mean that the member is acting in conformity with other applicable laws and rules. A member that offers an investment analysis tool under this Interpretive Material (whether customers use the member's tool independently or with assistance from the member) is responsible for ensuring that use of the investment analysis tool and all recommendations based on the investment analysis tool (whether made via the automated tool or a written report) comply, as applicable, with NASD's suitability rule (Rule 2310), the other provisions of Rule 2210 (including, but not limited to, the principles of fair dealing and good faith, the prohibition on exaggerated, unwarranted or misleading statements or claims, and any other applicable filing requirements for advertisements and sales literature), the federal securities laws (including, but not limited to, the antifraud provisions), the Securities and Exchange Commission rules (including, but not limited to, SEC Rule 156 under the Securities Act of 1933) and other NASD rules.

**(b) Definition**

For purposes of this Interpretive Material and any interpretation thereof, an "investment analysis tool" is an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are undertaken, thereby serving as an additional resource to investors in the evaluation of the potential risks and returns of investment choices.

**(c) Use of Investment Analysis Tools and Related Written Reports and Sales Material**

A member may provide an investment analysis tool (whether customers use the member's tool independently or with assistance from the member), written reports indicating the results generated by such tool and related sales material<sup>3</sup> only if:

- (1) the member describes the criteria and methodology used, including the investment analysis tool's limitations and key assumptions;
- (2) the member explains that results may vary with each use and over time;
- (3) if applicable, the member describes the universe of investments considered in the analysis, explains how the tool determines which securities to select, discloses if the tool favors certain securities and, if so, explains the reason for the selectivity<sup>4</sup>; and states that other investments not considered may have characteristics similar or superior to those being analyzed; and

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<sup>3</sup> Sales material that contains only an incidental reference to an investment analysis tool (e.g., a brochure that merely mentions a member's tool as one of the services offered by the member) need not include the disclosures required by this Interpretive Material and would not need to be filed with the Department, unless otherwise required by the other provisions of Rule 2210.

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(4) the member displays the following additional disclosure: “IMPORTANT: The projections or other information generated by [name of investment analysis tool] regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results.”

**(d) Disclosures**

The disclosures and other required information discussed in paragraph (c) must be clear and prominent and must be in written or electronic narrative form.

\* \* \* \* \*

- 4 This disclosure must indicate, among other things, whether the investment analysis tool searches, analyzes or in any way favors certain securities within the universe of securities considered based on revenue received by the member in connection with the sale of those securities or based on relationships or understandings between the member and the entity that created the investment analysis tool. The disclosure also must indicate whether the investment analysis tool is limited to searching, analyzing or in any way favoring securities in which the member makes a market or has any other direct or indirect interest. Members are not required to provide a “negative” disclosure (i.e., a disclosure indicating that the tool does *not* favor certain securities).

# Notice to Members

NOVEMBER 2004

## SUGGESTED ROUTING

Internal Audit  
Legal and Compliance  
Municipal/Government Securities  
Operations  
Trading and Market Making

## KEY TOPICS

Holiday Trade Date–Settlement Date  
Schedule

INFORMATIONAL

## Trade Date–Settlement Date

### 2005 Trade Date–Settlement Date Schedule

### Martin Luther King, Jr., Day:

#### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market® and the securities exchanges will be closed on Monday, January 17, 2005, in observance of Martin Luther King, Jr., Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Jan. 11	Jan. 14	Jan. 19
12	18	20
13	19	21
14	20	24
17	Markets Closed	—
18	21	25

## Presidents' Day:

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, February 21, 2005, in observance of Presidents' Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Feb. 15	Feb. 18	Feb. 23
16	22	24
17	23	25
18	24	28
21	Markets Closed	—
22	25	March 1

## Good Friday:

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Good Friday, March 25, 2005. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
March 21	March 24	March 29
22	28	30
23	29	31
24	30	April 1
25	Markets Closed	—
28	31	4

## Memorial Day:

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, May 30, 2005, in observance of Memorial Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
May 24	May 27	June 1
25	31	2
26	June 1	3
27	2	6
30	Markets Closed	—
31	3	7

## Independence Day:

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, July 4, 2005, in observance of Independence Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
June 28	July 1	July 6
29	5	7
30	6	8
July 1	7	11
4	Markets Close	—
5	8	12

## Labor Day:

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, September 5, 2005, in observance of Labor Day.

"Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Aug. 30	Sept. 2	Sept. 7
31	6	8
Sept 1	7	9
2	8	12
5	Markets Closed	—
6	9	13

## Columbus Day:

### Trade Date–Settlement Date Schedule

The schedule of trade dates-settlement dates below reflects the observance by the financial community of Columbus Day, Tuesday, October 11, 2005. On this day, The Nasdaq Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed.

Trade Date	Settlement Date	Reg. T Date*
Oct. 5	Oct. 10	Oct. 12
6	12	13
7	13	14
10	14	17
11	14	18
12	17	19

**Note:** October 11, 2005, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. Transactions made on Tuesday, October 11, will be combined with transactions made on the previous business day, October 10, for settlement on October 14. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on October 11.

## Veterans' Day and Thanksgiving Day:

**Note:** November 11, 2004, is considered a business day for receiving customers' payments under Regulation T of the Federal Reserve Board. Transactions made on November 11 will be combined with transactions made on the previous business day, November 10, for settlement on November 16. Securities will not be quoted ex-dividend, and settlements, marks to the market, reclamations, and buy-ins and sell-outs, as provided in the Uniform Practice Code, will not be made and/or exercised on November 11.

### Trade Date–Settlement Date Schedule

The schedule of trade dates–settlement dates below reflects the observance of the financial community of Veterans' Day, Friday, November 11, 2005, and Thanksgiving Day, Thursday, November 24, 2005. On Friday, November 11, The Nasdaq Stock Market and the securities exchanges will be open for trading. However, it will not be a settlement date because many of the nation's banking institutions will be closed in observance of Veterans' Day. All securities markets will be closed on Thursday, November 24, 2005, in observance of Thanksgiving Day.

Trade Date	Settlement Date	Reg. T Date*
Nov. 7	Nov. 10	Nov. 14
8	14	15
9	15	16
10	16	17
11	16	18
14	17	21
18	23	28
21	25	29
22	28	30
23	29	Dec 1
24	Markets Closed	—
25	30	2

## Christmas Day:

### Trade Date–Settlement Date Schedule

The Nasdaq Stock Market and the securities exchanges will be closed on Monday, December 26, 2005, in observance of Christmas Day. "Regular way" transactions made on the business days noted below will be subject to the following schedule:

Trade Date	Settlement Date	Reg. T Date*
Dec. 20	Dec. 23	Dec. 28
21	27	29
22	28	30
23	29	Jan 3, 2006
26	Markets Closed	—
27	30	4

Brokers, dealers, and municipal securities dealers should use the foregoing settlement dates for purposes of clearing and settling transactions pursuant to the NASD® Uniform Practice Code and the Municipal Securities Rulemaking Board Rule G-12 on Uniform Practice.

Questions regarding the application of those settlement dates to a particular situation may be directed to the Market Integrity Department at (203) 375-9609.

\* Pursuant to Sections 220.8(b)(1) and (4) of Regulation T of the Federal Reserve Board, a broker/dealer must promptly cancel or otherwise liquidate a customer purchase transaction in a cash account if full payment is not received within five business days of the date of purchase or, pursuant to Section 220.8(d)(1), make application to extend the time period specified. The date by which members must take such action is shown in the column titled "Reg. T Date."

# Notice to Members

NOVEMBER 30, 2004

INFORMATIONAL

SUGGESTED ROUTING

Executive Representatives

## NASD Notice of Meeting and Proxy

KEY TOPICS

Board Elections

### Executive Summary

The Annual Meeting of Members of NASD will be held on January 4, 2005, at 11:00 am, at the NASD Visitors Center, 1735 K Street, NW, in Washington, DC. The purpose of the meeting is to conduct the election of Governors to the NASD Board. Members can raise other topics for discussion by properly notifying NASD of these topics.<sup>1</sup> The record date for the Annual Meeting is the close of business on November 29, 2004.

It is important that all members be represented at the Annual Meeting. Members are urged to vote in the election of Board members using one of the methods described below.

### Board of Governors Election

There are seven vacancies to be filled at this meeting: four Industry governorships and three Public governorships. The nominees for the vacancies are listed in Attachment A. The nominees elected will serve for terms specified in Attachment A.

Attachment B includes the biographies of the nominees of the NASD National Nominating Committee (NNC). Attachment C contains the names of the current Board of Governors.

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## Voting Methods

Members will be able to vote using one of the following methods:

- ▶ U.S. mail
- ▶ Internet
- ▶ Phone

The enclosed proxy contains detailed instructions on the voting procedures.

## Questions/Further Information

Questions regarding this *Notice* may be directed to:

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

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## **ATTACHMENT A**

### **NASD Board of Governors Nominees**

The following seven persons 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	Senior 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 Firm)

#### **PUBLIC**

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

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## ATTACHMENT B

### NASD Profiles of Board Nominees for Industry Governor

**John W. Bachmann** is Senior 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. Mr. Bachmann is currently Chairman of the U. S. Chamber of Commerce and a Director of AMR American Airlines and the Monsanto Company. 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 the 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 Soloman 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.

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**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 the 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 the 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 Governor

**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. Mr. Burton is a past officer of the National Association of State Retirement Administrators and 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 plc 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.

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## ATTACHMENT C

### Current Board of Governors

#### Governors with Terms Expiring in January 2005

##### INDUSTRY

John W. Bachmann	Senior 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 Firm)
Barbara L. Weaver <sup>2</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)
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##### PUBLIC

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

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

##### PUBLIC

Kenneth M. Duberstein*	Chairman and CEO, The Duberstein Group, Inc.
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\* Not eligible for re-election

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## 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

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## Endnotes

- 1 Pursuant to Sections 1 and 3(b) of Article XXI of the NASD By-Laws, an NASD member may properly bring any other business before the Annual Meeting by giving timely notice in writing to the Secretary of NASD. In addition, the member must be an NASD member at the time of the delivery of such notice, and the other business must be a proper matter for member action. To be timely, a member's notice must be delivered to the Secretary at NASD's principal executive offices (the address is listed above) within 25 days after the date of this notice.
- 2 The Chair of the National Adjudicatory Council serves a one-year term on the NASD Board.

The member's notice must offer a brief description of the other business, any material interest of the member in such business, and the reasons for conducting such business at the Annual Meeting.

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# Disciplinary and Other NASD Actions

## REPORTED FOR NOVEMBER

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules, and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of October 2004.

### Firms Fined, Individuals Sanctioned

Garden State Securities, Inc. (CRD #10083, Wall, New Jersey), George Kenneth Bicking (CRD #21054, Registered Principal, Holmdel, New Jersey), and Paul William Ponn (CRD #1645923, Registered Principal, Matawan, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$20,000, jointly and severally with Bicking, and required to revise the firm's written supervisory procedures regarding quotation and trading activity within 30 business days. Bicking was suspended from association as a general securities principal for 15 business days. Ponn was fined \$25,000 and suspended from association with any NASD member in any capacity for 90 days. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that Ponn engaged in a course of conduct through which small buy (sell) orders were entered into an electronic communications network (ECN) at prices that affected the national best bid (offer) (NBBO) to facilitate the automatic execution of larger sell (buy) orders on the opposite side of the market by a market maker that guaranteed that they would provide executions at the NBBO price, thereby permitting Ponn to buy (sell) shares of a NASDAQ National Market® (NNM)® security at prices that otherwise would not have been available in the market. The findings also stated that Bicking failed to establish, maintain, and enforce a supervisory system reasonably designed to detect and prevent fraudulent, manipulative, and deceptive quotation and trading activity. NASD also found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning fraudulent, deceptive, and manipulative quotation and trading activity.

Bicking's suspension began November 1, 2004, and will conclude at the close of business November 19, 2004. Ponn's suspension began November 1, 2004, and will conclude January 29, 2005. (NASD Case #CMS040148)

Northwestern Mutual Investment Services, LLC (CRD #2881, Milwaukee, Wisconsin), Thomas Garland Lipscomb, III (CRD #1371451, Registered Representative, Overland Park, Kansas), Daniel Edward Brunette (CRD #813924, Registered Representative, Indianapolis, Indiana) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$1,000,000, and required to file with NASD's Advertising Regulation Department all institutional sales materials used for educational purposes relating to internal seminars and training sessions about variable life insurance

products prior to their first use for one year from the date of acceptance of this AWC. The firm was also required to provide notice to all current firm registered representatives that attended Lipscomb's seminars from May 18, 1998, through October 22, 2001, that explains the deficiencies identified in this AWC of the seminars. Lipscomb was censured, fined \$250,000, suspended in any capacity for 30 business days, and ordered to requalify as a Series 6 investment company products/variable contracts representative. Brunette was censured, fined \$10,000, and suspended in any capacity for five business days.

Without admitting or denying the allegations, the firm, Lipscomb, and Brunette consented to the described sanctions and to the entry of findings that Lipscomb conducted training seminars for firm sales agents that emphasized the investment aspects of a variable life insurance while downplaying the insurance aspects, presented a simplistic and inaccurate depiction of its tax implications, and failed to describe sufficiently the risks of using the policy in the manner he recommended. The findings also stated that the firm was aware of concerns with Lipscomb's seminars but failed to take adequate action to address these concerns nor was Lipscomb disciplined by the firm for failing to make requested changes to the seminar. NASD also found that Brunette failed to describe clearly the variable life insurance policy in letters to public customers and the firm, despite knowing that Brunette had used inappropriate terms in communications with public customers, failed to take adequate and timely action to monitor and supervise his written correspondence with customers. In addition, NASD found that the firm failed to retain e-mails for three years, or for the first two years in an accessible place.

Lipscomb's suspension began October 18, 2004, and will conclude at the close of business November 26, 2004. Brunette's suspension began October 18, 2004, and concluded at the close of business October 22, 2004. (NASD Case #CAF040075)

**Sumner Harrington, Ltd. (CRD #45858, Minnetonka, Minnesota), Kim Edward Elverud (CRD #2139216, Registered Principal, Bloomington, Minnesota), William Eugene Casey (CRD #2244596, Registered Principal, St. Paul, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$60,000, jointly and severally with Elverud, and required to submit all advertisements and sales literature relating to the specific products or services prepared by or for the firm or its affiliates to NASD's Advertising Regulation Department for approval prior to distribution to the public for a period of nine months following the acceptance of this AWC. The firm was also required to notify each current holder of renewable unsecured subordinated notes of a securities issuer of the outcome of this AWC by first class mail and shall, at a minimum, include a copy of this AWC or press release. The firm also was required to retain an outside

consultant to review and make recommendations concerning the adequacy of the firm's current policies and procedures as they relate to suitability under NASD rules and federal securities laws. Elverud was suspended from association with any NASD member in any capacity for 20 days. Upon completion of the suspension in any capacity, Elverud will be suspended from acting in any supervisory capacity or as a trainer of personnel with any NASD member for nine months. Elverud was also required to requalify by examination as a Series 24 principal before the completion of the nine-month supervisory suspension. If Elverud has not requalified, he shall be prohibited from serving in any principal capacity until he has successfully requalified. Casey was fined \$5,000, suspended from association with any NASD member in any capacity for 20 days, and required to requalify by examination as a Series 24 principal within three months after the acceptance of this AWC or cease serving in that capacity.

Without admitting or denying the allegations, the firm, Elverud, and Casey consented to the described sanctions and to the entry of findings that the firm, acting through Elverud and Casey, made unsuitable recommendations to public customers regarding securities offerings without having reasonable grounds for believing the recommendations were suitable for particular customers upon the basis of the facts disclosed prior to the transactions and failed to make reasonable efforts to obtain additional information concerning the customer's financial status, investment objectives, and other information relevant to making a determination as to suitability. The findings also stated that the firm received compensation in connection with the offerings and failed to provide any explanation or documentation to NASD describing changes in the firm's underwriting compensation. In addition, the firm's advertising revenue was not disclosed in the offering materials distributed to the investing public. NASD also found that the firm's investment kits and advertisements failed to disclose that the firm was to receive commissions for its underwriting efforts and its advertising material, and that credit agencies had downgraded an issuer's credit rating or that the company's notes carried more risk. In addition, NASD found that the firm failed to disclose adequately consideration it received from securities issuers or the amount thereof in connection with notices, circulars, and advertisements distributed to the investing public. Moreover, NASD found that the firm's written supervisory procedures failed to address adequately suitability determinations for compliance with NASD Rule 2310. Furthermore, NASD found that the firm, through Elverud, failed to establish and maintain adequate procedures for the supervision of suitability determinations and to supervise adequately and monitor Casey's suitability determinations. Casey, in turn, failed to supervise adequately and monitor suitability determinations made by another employee under his charge.

Elverud's suspension in any capacity began November 1, 2004, and will conclude November 20, 2004. Elverud's

suspension in a supervisory or personnel trainer capacity will begin November 22, 2004, and will conclude at the close of business August 23, 2005. Casey's suspension began October 4, 2004, and concluded October 23, 2004. (NASD Case #CAF040069)

**Trautman Wasserman & Company, Inc. (CRD #33007, New York, New York) and Gregory Owen Trautman (CRD #1837389, Registered Principal, New York, New York)** submitted an Offer of Settlement in which the firm was fined \$100,000. Trautman was fined \$200,000, including disgorgement of \$135,000 of commissions in partial restitution to public customers, suspended from association with any NASD member in any capacity for 31 days, suspended from association with any NASD member as a Series 24, general securities principal for six months, and barred from association with any NASD member as a Series 55 equity trader. Without admitting or denying the allegations, the firm and Trautman consented to the described sanctions and to the entry of findings that the firm, acting through Trautman, offered a special sales credit to its registered representatives for selling a security and, either intentionally or recklessly failed to disclose or to take any steps to cause to be disclosed to public customers the special sales credit offered to the firm's registered representatives, depriving the customers of the knowledge that the registered representatives might be recommending stock based upon the their own financial interest rather than the investment value of the security. NASD also found that the firm failed to report to NASDAQ principal purchases and sales of the security. In addition, NASD found that the firm inaccurately reported securities transactions, failed to identify the report as an aggregate transaction, and reported the times of securities purchases to the Nasdaq Stock Market for which the corresponding order memoranda reflected a later time.

Moreover, NASD found that the firm was a market maker in penny stocks and effected transactions with public customers in the stocks although the stocks did not qualify for a transactional exemption from the Securities and Exchange Commission's (SEC) penny stock rules. The firm also failed to furnish the customers with the requisite risk disclosure document relating to the penny stock market and disclose the inside bid/outside offer quotations; failed to disclose the amount of compensation received by the firm and registered representatives; failed to give purchasing customers the requisite written statement relating to price determinations and market and price information for the penny stocks; and failed to properly approve the accounts for transactions in penny stocks for non-established customers and to receive the required purchase agreement. Moreover, NASD found that the firm's written supervisory procedures were not reasonably designed to achieve compliance with Regulation M of the Securities Exchange Act of 1934.

Trautman's suspension in a principal capacity began November 1, 2004, and will conclude April 30, 2005. Trautman's suspension in all capacities began November 1, 2004, and will conclude at the close of business December 1, 2004. (NASD Case #C3A030049)

## Firms and Individuals Fined

**Huntingdon Securities Corporation (CRD #16497, Minot, North Dakota) and Roger William Domres (CRD # 2190341, Registered Principal, Minot, North Dakota)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm and Domres were censured and fined \$10,000, jointly and severally. The fine must be paid before Domres reassociates with any NASD member or before the firm applies for membership with NASD. Without admitting or denying the allegations, the firm and Domres consented to the described sanctions and to the entry of findings that the firm, acting through Domres, generated approximately \$11,899 in revenue from the sale of options without having at least one properly qualified options principal. The findings also stated that that the firm permitted Domres to perform in a capacity requiring registration while he was deemed inactive due to his failure to complete timely the Regulatory Element of NASD's Continuing Education Requirements. NASD also found that the firm failed to establish and maintain an effective supervisory control system and supervisory procedures designed to ensure compliance with the Regulatory Element of NASD's Continuing Education Requirements. (NASD Case #C04040045)

## Firms Fined

**Professional Investment Services, Inc. (CRD #13703, Winfield, Kansas) and Don Howard Ehling (CRD #76203, Registered Principal, Winfield, Kansas)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm and Ehling were censured and fined \$22,500, jointly and severally. Without admitting or denying the allegations, the firm and Ehling consented to the described sanctions and to the entry of findings that the firm, acting through Ehling, failed to file timely its annual audited reports. The findings also stated that the firm, acting through Ehling, contravened SEC Rule 15c3-1 in that it utilized the instrumentalities of interstate commerce to conduct a securities business while failing to maintain minimum net capital. NASD also found that the firm, acting through Ehling, failed to prepare accurate net capital computations. (NASD Case #C04040044)

**American Express Financial Advisors, Inc. (CRD #6363, Minneapolis, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$400,000. Without admitting or denying the allegations, the

firm consented to the described sanctions and to the entry of findings that it failed to file with NASD's Advertising Regulation Department within 10 days of publication or first use, advertising and sales literature it used with the investing public. The findings also stated that the firm failed to obtain the written approval by a principal of pieces of advertising and sales literature prior to use with the investing public. NASD also found that the firm failed to establish, maintain, and enforce a supervisory system and procedures reasonable designed to achieve compliance with federal securities laws and NASD rules. In addition, NASD determined that the firm failed to monitor consistently and to enforce policies and procedures relating to advertising and sales literature. (NASD Case #CAF040072)

**Edward D. Jones & Co., L.P. (CRD #250, St. Louis, Missouri)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$200,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it encouraged its representatives to recommend the use of margin loans to public customers and failed to establish and maintain a supervisory system, including written supervisory procedures, reasonably designed to deter and prevent its representatives from making unsuitable recommendations regarding the use of margin loans in client accounts as a result of its bonus plan. (NASD Case #C07040079)

**Edward D. Jones & Co., L.P. (CRD #250, St. Louis, Missouri)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$15,000, and required to revise the firm's supervisory procedures regarding Trade Reporting and Compliance Engine (TRACE) reporting within 30 business days of acceptance of this AWC by the National Adjudicatory Council (NAC). Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it reported a price that included its markup/markdown and improperly reported the markup/markdown again as a commission in transactions reported to TRACE. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning the reporting of transactions to TRACE. NASD also found that the firm's supervisory system did not provide for supervision reasonably designed to ensure that the firm's automated TRACE reporting system reported trades in compliance with NASD's Marketplace Rule 6230(d)(1). (NASD Case #CMS040143)

**J. B. Hanauer & Co. (CRD #6958, Parsippany, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$7,500, ordered to pay \$6,882, plus interest, in restitution to public customers, and to update its written supervisory procedures as they relate to the determination of the fair market value of municipal securities

being bought or sold from a public customer. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it purchased municipal security positions from public customers for its own account then sold the securities at a nominal gain. Moreover, NASD determined that the prices paid to the customers, and received by the firm, were below the fair market value of each security. NASD also found that the firm failed to ensure that the transactions were executed at aggregate prices that were fair and reasonable. (NASD Case #C05040064)

**Lehman Brothers, Inc. (CRD #7506, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$13,000, and required to revise the firm's written supervisory procedures regarding SEC Rules 10a-1, 11Ac1-5, 11Ac1-6(ii), and Best Execution (Three Quote Rule) 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 accepted customer short sale orders in certain securities and, for each order, failed to make/annotate an affirmative determination that the firm would receive delivery of the security on behalf of the customer or that the firm could borrow the security on behalf of the customer for delivery by settlement date. The findings also stated that the firm effected short sales in certain securities for the firm's proprietary accounts and failed to make/annotate an affirmative determination that the firm could borrow the securities or otherwise provide for delivery of the securities by settlement date. NASD also found that the firm failed to mark memoranda for Consolidated Quotation System<sup>SM</sup> (CQS<sup>SM</sup>) proprietary transactions as long or short; executed short sales of CQS securities at prices below the last sale prices of the securities when it was not a market maker in any CQS security; and failed to provide written notification disclosing to its customers that the transactions were executed at an average price. In addition, NASD found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning SEC Rules 10A-1, 11Ac1-5, 11Ac1-6(ii), and Best Execution (Three Quote Rule). (NASD Case #CMS040140)

**Merrill Lynch, Pierce, Fenner & Smith Incorporated (CRD #7691, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$27,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit through the Automated Confirmation Transaction Service<sup>SM</sup> (ACT<sup>SM</sup>) last sale reports of transactions in eligible securities and OTC Equity securities and failed to designate through ACT such last sale reports as late. The findings also stated that the firm incorrectly designated as late to ACT last sale reports of transactions in eligible securities. (NASD Case #CMS040146)

**Quick & Reilly, Inc. (CRD #11217, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$5,000, ordered to pay \$5,137.50, plus interest, in restitution to public customers, and to update its written supervisory procedures as they relate to the determination of the fair market value of municipal securities being bought or sold from a public customer. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it purchased municipal security positions from public customers for its own account then sold the securities at a nominal gain. Moreover, NASD determined that the prices paid to the customers, and received by the firm, were below the fair market value of each security. NASD also found that the firm failed to ensure that the transactions were executed at aggregate prices that were fair and reasonable. **(NASD Case #C05040066)**

**RBC Dain Rauscher, Inc. (CRD #31194, Minneapolis, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, ordered to pay \$8,714.50, plus interest, in restitution to a public customer, and to update its written supervisory procedures as they relate to the determination of the fair market value of municipal securities bought or sold from a public customer. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it purchased a municipal security position from a public customer for its own account and then sold the security at a nominal gain. Moreover, NASD determined that the price paid to the customer, and received by the firm, was below the fair market value of the security. NASD also found that the firm failed to ensure that the transactions were executed at aggregate prices that were fair and reasonable. **(NASD Case #C05040068)**

**Royal Alliance Associates, Inc. (CRD #23131, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$11,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that the firm failed to accept or decline in ACT transactions in eligible securities within 20 minutes after execution that the firm had an obligation to accept or decline in ACT as the order entry identifier (OEID). **(NASD Case #CMS040142)**

**Safeco Securities, Inc. (CRD #739, Redmond, Washington)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it used instrumentalities of interstate commerce to effect transactions in securities while failing to maintain required net capital of not less than \$5,000. **(NASD Case #C3B040025)**

**UBS Securities, LLC (CRD #7654, Stamford, Connecticut)** submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$25,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it incorrectly designed as ".PRP" through ACT last sale reports of transactions in NNM securities; transmitted to the Order Audit Trail System<sup>SM</sup> (OATS<sup>SM</sup>) reports that contained inaccurate, incomplete, or improperly formatted data; and failed to provide written notification disclosing to its customers that transactions were executed at an average price. The findings also stated that the firm made available a report on covered orders in national market securities that it received for execution from any person that included incorrectly classified orders and incorrectly calculated order execution data. **(NASD Case #CMS040147)**

## Individuals Barred or Suspended

**Douglas Roy Albert (CRD #1040077, Registered Representative, Nesconset, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 90 days. Without admitting or denying the allegations, Albert consented to the described sanctions and to the entry of findings that he altered an Investor Acknowledgment of Risk With Respect to Real Estate Investment Trusts form for the account of a public customer. The findings also stated that Albert changed the dates and account number on the document and, after making these changes, submitted the form to his supervisor as a new document for approval to transfer a portion of the customer's individual retirement account into a real estate investment trust investment.

Albert's suspension began October 4, 2004, and will conclude at the close of business January 3, 2005. **(NASD Case #CLI040024)**

**Robert Scott Bales (CRD #1174731, Registered Representative, Mattituck, 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, Bales consented to the described sanction and to the entry of findings that he failed to respond to NASD requests to appear for testimony. **(NASD Case #CLI040023)**

**Samuel Jay Begun (CRD #2376641, Registered Representative, Potomac, Maryland)** 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, Begun consented to the described sanction and to the entry of findings that he received \$30,000 from a public customer to invest in a real estate business venture Begun had described, and that Begun

improperly treated these funds as a personal loan from the customer. (NASD Case #C9A040043)

**Brookes McIntosh Bendetsen (CRD #1374304, Registered Principal, Burlingame, California)** was barred from association with any NASD member in any capacity. The NAC imposed the sanction following appeal of an Office of Hearing Officers (OHO) decision. The sanction was based on findings that Bendetsen signed the name of a public customer to a margin agreement for the customer's trust account without written authorization of the customer. The findings also stated that Bendetsen recommended and effected short sales of shares in the account of a public customer without having a reasonable basis for believing the transactions were suitable for the customer based on the customer's financial situation, investment objectives, and needs. NASD also found that Bendetsen created and provided to the customer false account statements in order to conceal losses in the customer's trust account. (NASD Case #C01020025)

**Donna Marie Bishop (CRD #1502667, Registered Representative, Glastonbury, Connecticut)** 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, Bishop consented to the described sanction and to the entry of findings that she misappropriated funds totaling \$81,662 from public customers for her own use and benefit without the knowledge, consent, or authorization of the customers. The findings also stated that Bishop failed to respond to NASD requests for information and documents. (NASD Case #C11040034)

**Bruce George Boyle (CRD #1796066, Registered Principal, Hauppauge, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, suspended from association with any NASD member in any capacity for 30 days, and suspended from association with any NASD member in a principal capacity for 15 days. After consideration of a suspension in any capacity for 30 days previously imposed by Boyle's firm, Boyle was given full credit for serving the 30-day suspension. Without admitting or denying the allegations, Boyle consented to the described sanctions and to the entry of findings that, while employed as the operations manager for his member firm, and without his firm's knowledge or approval, he produced order tickets that, while not inaccurate, were not made at the time of the transaction and were created by Boyle in response to NASD staff requests.

Boyle's suspension in a principal capacity began October 4, 2004, and concluded at the close of business October 18, 2004. (NASD Case #C10040095)

**Bradley Scott Brunner (CRD #2707045, Registered Principal, Chico, California)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying

the allegations, Brunner consented to the described sanction and to the entry of findings that he converted \$24,000 from a private organization that was unrelated to his member firm for his own personal use and benefit. (NASD Case #C01040023)

**Rolf Willy Brunner (CRD #2052632, Registered Representative, Short Hills, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Brunner reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Brunner consented to the described sanctions and to the entry of findings that, pursuant to his employment agreement with his member firm, in the event that his customer account assets totaled more than \$30 million, he would be paid a forgivable loan of 30 basis points for each dollar under management. The findings stated that because Brunner's assets would not have entitled him to the forgivable loan before the expiration time to qualify, other registered representatives at Brunner's member firm permitted several of their joint customer accounts to be temporarily transferred to Brunner so that he could reach a qualifying level of account assets and thereby obtain a forgivable loan. NASD also found that Brunner received a forgivable loan of \$138,974.16 from his member firm and shared a portion of the proceeds with the registered representatives.

Brunner's suspension began November 1, 2004, and will conclude at the close of business October 31, 2005. (NASD Case #C10040098)

**John David Buglisi (CRD #2977744, Registered Representative, Lido Beach, New York)** submitted an Offer of Settlement in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for 45 days. Without admitting or denying the allegations, Buglisi consented to the described sanctions and to the entry of findings that he purchased and sold shares of stock and call options in public customer accounts without the customers' knowledge, consent, or authorization.

Buglisi's suspension began November 1, 2004, and will conclude at the close of business December 15, 2004. (NASD Case #CLI040001)

**Melzina Cannon (CRD #2944615, Registered Representative, Detroit, Michigan)** submitted a Letter of Acceptance, Waiver, and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 business days. The fine must be paid before Cannon reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Cannon consented to the described sanctions and to the entry

of findings that she failed to disclose a material fact on her Uniform Application for Securities Industry Registration or Transfer (Form U4).

Cannon's suspension began November 1, 2004, and will conclude at the close of business December 13, 2004. (NASD Case #C8A040083)

**Dennis Arthur Cooke, Sr. (CRD #1627734, Registered Representative, Havertown, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was suspended from association with any NASD member in any capacity for three months. In light of the financial status of Cooke, no monetary sanctions were imposed. Without admitting or denying the allegations, Cooke consented to the described sanction and to the entry of findings 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.

Cooke's suspension began October 18, 2004, and will conclude at the close of business January 17, 2005. (NASD Case #C9A040041)

**David Walter Coyman (CRD #2148069, Registered Representative, Long Valley, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, suspended from association with any NASD member in any capacity for six months, and ordered to disgorge \$15,000 in commissions in partial restitution to public customers. The fine and restitution amounts must be paid before Coyman reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Coyman consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without prior written notice to, and approval from, his member firms.

Coyman's suspension began November 1, 2004, and will conclude April 30, 2005. (NASD Case #C9B040089)

**Shabnam Das (CRD #2621453, Registered Representative, Frederick, Maryland)** submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Das consented to the described sanction and to the entry of findings that she caused \$113,000 to be withdrawn from public customer accounts without the customers' knowledge or authorization. The findings also stated that Das converted a portion of the funds for her own use and benefit. (NASD Case #C9A040040)

**Deidre Thompson Day (CRD #1081698, Registered Representative, Stockbridge, Georgia)** 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, Day consented to the described sanction and to the entry of findings that she failed to respond to NASD requests for information. (NASD Case #C07040078)

**Alfredo Diaz (CRD #2125018, Registered Principal, Plandome, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any principal or supervisory capacity for 15 business days. Without admitting or denying the allegations, Diaz consented to the described sanctions and to the entry of findings that he failed to supervise an individual that he knew was engaged in outside business activities and failed to ensure that the individual provide prompt written notice of his activities to their member firm.

Diaz' suspension began October 18, 2004, and concluded at the close of business November 5, 2004. (NASD Case #C9B040087)

**Sebastien Courtney Dufort (CRD #2143800, Registered Principal, Hinsdale, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Dufort reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Dufort consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transactions in the account of a public customer on a discretionary basis without prior written authorization from the customer and acceptance in writing by Dufort's member firm of the account as discretionary. The findings also stated that Dufort placed orders for transactions in the account of a public customer at another member firm without first notifying his member firm and the executing member firm in writing of his association with the other firm.

Dufort's suspension began October 4, 2004, and concluded at the close of business November 2, 2004. (NASD Case #C8A040080)

**John Ettore (CRD #2580761, Registered Representative, Mahopac, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 60 days. In addition, Ettore shall not be supervised by any individual previously associated with a disciplined firm as defined in NASD Rule 3010(b)(2)(J). Ettore shall also be subject to special supervision including, but not limited to, the monitoring of his sales presentations on at least a monthly basis for one year

after he becomes registered with a member firm. The fine must be paid before Etere reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Etere consented to the described sanctions and to the entry of findings that he used high-pressure sales tactics and knowingly made numerous baseless predictions of substantial price increases and material misrepresentations of fact in connection with his solicitation of customers and prospective customers to purchase equity securities.

Etere's suspension began October 25, 2004, and will conclude at the close of business December 23, 2004. (NASD Case #C07040081)

**Charles Elwood Greenway (CRD #1229685, Registered Principal, Lees Summit, Missouri)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. The sanction was based on findings that Greenway converted \$185,200 from the accounts of public customers without the knowledge, authorization, or consent of the customers. The findings also stated that Greenway failed to respond to NASD requests for information. (NASD Case #C04040043)

**Donald Joe Godwin (CRD #1287029, Registered Principal, Nashville, Tennessee)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Godwin failed to respond to NASD requests for information. The findings also stated that Godwin engaged in an outside business activity and failed to provide written notice to his member firms. (NASD Case #C07040038)

**Chris Dinh Hartley (CRD #1799834, Registered Representative, San Jose, California)** was fined \$7,500 and suspended from association with any NASD member in any capacity for 90 days. The SEC affirmed the sanctions imposed by the NAC. The sanctions were based on findings that Hartley engaged in private securities transactions and failed to give prior written notice to, or receive written approval from, his member firm prior to engaging in such activities.

Hartley's suspension began October 18, 2004, and will conclude January 15, 2005. (NASD Case #C01010009)

**Anthony Eugene Hoffman (CRD #1872765, Registered Representative, North Canton, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for two months. The fine must be paid before Hoffman reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hoffman consented to the described sanctions and to the entry of findings that he failed to submit timely an amended Form U4 disclosing material information.

Hoffman's suspension began November 1, 2004, and will conclude at the close of business December 31, 2004. (NASD Case #C8A040084)

**Steven Gregory Hoffman (CRD #1175434, Registered Representative, Houston, Texas)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 15 business days. Without admitting or denying the allegations, Hoffman consented to the described sanctions and to the entry of findings that he failed to disclose and/or amend his Form U4 to disclose material facts.

Hoffman's suspension began October 18, 2004, and concluded at the close of business November 5, 2004. (NASD Case #C06040014)

**Joseph Raymond Huard, Jr. (CRD #1025521, Registered Principal, Lake Worth, Florida)** 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, Huard consented to the described sanction and to the entry of findings that he pled guilty to two felony charges in violation of NASD Conduct Rule 2110. (NASD Case #C9B040085)

**Melissa Mae Humphreys (CRD #4474941, Registered Representative, Tampa, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Humphreys, as an employee of an affiliated bank of a member firm, caused the issuance of new debit/ATM cards for bank customers without their knowledge or authorization, and used the cards to make cash withdrawals and purchases totaling \$9,096.21 for her own benefit against the customers' bank accounts. The findings also stated that Humphreys failed to respond to NASD requests for information. (NASD Case #C07040036)

**Robert Yoon Hyun (CRD #4374116, Registered Representative, Bellevue, Washington)** submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hyun consented to the described sanction and to the entry of findings that he solicited and obtained payments from public customers totaling \$286,000 intended to be used to purchase securities but, instead, converted and misused the funds for his own use and benefit without the knowledge, consent, or authorization of the customers. The findings also stated that Hyun failed to respond to NASD requests for information. (NASD Case #C3B040022)

**Karl Emil Keirstead (CRD #2526412, Registered Representative, East Hampton, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$21,000, including disgorgement of after-tax transaction profits, and suspended from association with any NASD member in any

capacity for 60 days. The fine must be paid before Keirstead reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Keirstead consented to the described sanctions and to the entry of findings that he violated NASD's free-riding and withholdings interpretation when he knowingly purchased and sold shares of a hot issue through his girlfriend while he was registered as a general securities representative through his member firm.

Keirstead's suspension began October 4, 2004, and will conclude at the close of business December 2, 2004. (NASD Case #C10040096)

**Gary Scott Lochansky (CRD #2574846, Registered Representative, Jersey City, New Jersey)** 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, Lochansky consented to the described sanction and to the entry of findings that he submitted, or caused to be submitted, an application for a \$1,000,000 deferred variable annuity to an insurance company in the name of a fictitious person. The findings also stated that Lochansky entered into an agreement with his sales manager to participate jointly in a financial trade show and to split the costs between them, falsely represented to his sales manager that he had paid \$3,750 of the costs, and provided him a copy of an invoice falsely marked to indicate such payment. NASD found that Lochansky's sales manager gave him a \$1,775 check that Lochansky deposited into his personal bank account, failed to make any payment on the trade show invoice, failed to use the proceeds of the check to make any payment on the invoice, and failed to refund or repay the money to his sales manager. (NASD Case #C9B040072)

**Hardat Mahadeo (CRD #1948439, Registered Representative, New York, New York)** submitted an Offer of Settlement in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for six weeks. The fine must be paid before Mahadeo reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Mahadeo consented to the described sanctions and to the entry of findings that he engaged in a private securities transaction away from his member firm and failed to provide written notification to his firm. The findings also stated that Mahadeo failed to amend his Form U4 to disclose material information.

Mahadeo's suspension began November 1, 2004, and will conclude December 12, 2004. (NASD Case #C10040045)

**Kristine Louise Martin (CRD #3143633, Registered Representative, Scottsdale, Arizona)** 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, Martin consented to the described sanction and to the entry of findings that she transferred funds totaling \$11,444 from a public customer's money manager account and used the funds to make credit card payments in which Martin had an interest without the customer's authorization. (NASD Case #C3A040041)

**Rick Lee Matney (CRD #1828590, Registered Representative, Marshalltown, Iowa)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Matney reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Matney consented to the described sanctions and to the entry of findings that he received \$2,018.80 from a public customer to cover premiums for property and casualty insurance. The findings stated that Matney discovered that his insurance company would not underwrite the insurance, failed to inform the customer, and, instead, applied the check to premiums for existing insurance policies held by the customer. NASD also found that Matney fabricated insurance declaration pages for the insurance purportedly underwritten by his insurance company to satisfy the customer's request for information about the insurance.

Matney's suspension began November 1, 2004, and will conclude at the close of business October 31, 2005. (NASD Case #C04040036)

**Jamie Patrick McNamara (CRD #4546647, Registered Representative, Lees Summit, Missouri)** 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, McNamara consented to the described sanction and to the entry of findings that he received \$388 from a public customer to obtain automobile insurance coverage, deposited the funds into a personal d/b/a account, and failed to purchase the insurance coverage for the customer as intended. The findings also stated that McNamara created a fictitious automobile insurance card for the customer to alleviate the customer's concerns that she did not have automobile insurance coverage. NASD also found that McNamara failed to respond to NASD requests for information. (NASD Case #C04040040)

**John Preston Middleton, III (CRD #1915353, Registered Representative, Lynchburg, Virginia)** 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, Middleton consented to the described sanction and to the entry of findings that he caused loan checks totaling \$10,590 to be issued against life insurance policies owned by public customers, obtained possession of the checks, forged the customers' endorsements

on the checks, and converted the funds for his own use and benefit without the customers' knowledge or authorization. The findings further stated that Middleton failed to respond to NASD requests for information. (NASD Case #C9A040044)

**John Troy Morrison (CRD #1033116, Registered Supervisor, Springfield, Pennsylvania)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any principal or supervisory capacity for 10 business days. Without admitting or denying the allegations, Morrison consented to the described sanctions and to the entry of findings that he failed to supervise a registered representative who recommended and effected transactions in the accounts of public customers without having reasonable grounds for believing that the transactions were suitable, or that using margin was suitable. The findings also stated that Morrison failed to take appropriate action to supervise the registered representative to prevent violations and achieve compliance with applicable securities laws, regulations, and NASD rules.

Morrison's suspension began October 18, 2004, and concluded at the close of business October 29, 2004. (NASD Case #C9A040042)

**John R Murdock, III (CRD #4464537, Registered Representative, Texarkana, Texas)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Murdock received checks and cash totaling \$3,737.50 for insurance premium payments from public customers and converted the funds for his personal benefit without the customers' knowledge. NASD also found that Murdock failed to respond to NASD requests for information. (NASD Case #C06040009)

**Christopher Martin Murray (CRD #4187317, Registered Principal, New York, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member in any capacity for 10 business days, and ordered to pay \$24,000 in restitution to a public customer. Without admitting or denying the allegations, Murray consented to the described sanctions and to the entry of findings that he recommended the purchase of a common stock to a corporate customer without having reasonable grounds to believe that the recommendation and resultant transaction were suitable for the customer's financial situation and needs.

Murray's suspension began November 1, 2004, and concluded at the close of business November 12, 2004. (NASD Case #CLI040025)

**Edmund Anthony Palmieri, Jr. (CRD #2123194, Registered Representative, Scotch Plains, New Jersey)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member

in any capacity for 30 days. Without admitting or denying the allegation, Palmieri consented to the described sanctions and to the entry of findings that he engaged in outside business activities and failed to provide prompt written notice to his member firm.

Palmieri's suspension began October 18, 2004, and will conclude at the close of business November 16, 2004. (NASD Case C9B040088)

**Frank Palumbo (CRD #2165975, Registered Principal, Dix Hills, New York)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the allegations, Palumbo consented to the described sanctions and to the entry of findings that he effected a transaction in a public customer's account without the customer's knowledge, consent, or authorization.

Palumbo's suspension began November 1, 2004, and concluded at the close of business November 5, 2004. (NASD Case #CLI040026)

**Alfred Thomas Petrecca (CRD #4594840, Associated Person, Enola, Pennsylvania)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Petrecca failed to respond to NASD requests for information and to appear and provide testimony. The findings also stated that Petrecca willfully failed to disclose material information on his Form U4. (NASD Case #C9A040013)

**Robert Mark Racusen (CRD #1601853, Registered Representative, Buffalo Grove, Illinois)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Racusen reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Racusen consented to the described sanctions and to the entry of findings that he engaged in securities transactions in the account of a public customer without the knowledge or consent of the customer and in the absence of written or oral authorization to Racusen to exercise discretion in the customer's account.

Racusen's suspension began November 1, 2004, and will conclude at the close of business October 31, 2005. (NASD Case #C8A040089)

**Rooney Arun Sahai (CRD #1551326, Registered Representative, Ridgewood, New Jersey)** was barred from association with any NASD member in any capacity. The NAC imposed the sanction following appeal of an OHO decision. The sanction was based on findings that Sahai forged the signatures of public customers on documents; purchased a variable annuity

on behalf of a public customer without her prior knowledge, authorization, and consent; and failed to respond to NASD requests for information. (NASD Case #C9B020032)

This case has been appealed to the SEC, and the bar is in effect pending consideration of the appeal.

**Joseph A. Sciamanna (CRD #4655238, Registered Representative, Bensalem, Pennsylvania)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Sciamanna reassociates with any NASD member or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Sciamanna consented to the described sanctions and to the entry of findings that he failed to disclose material information on his Form U4.

Sciamanna's suspension began October 4, 2004, and will conclude April 3, 2005. (NASD Case #C9A040027)

**Christopher Kenneth Somers (CRD #2659495, Registered Representative, Philadelphia, 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 one year. In light of the financial status of Somers, the fine imposed was \$10,000. The fine must be paid before Somers reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Somers consented to the described sanctions and to the entry of findings that he recommended and effected securities transactions in the account of a public customer without having reasonable grounds to believe that the transactions recommended were suitable in light of the excessively high levels of transactional costs, in relation to the assets of the account, incurred by the account.

Somers' suspension began October 4, 2004, and will conclude at the close of business October 3, 2005. (NASD Case #C9A040039)

**Danny Ray Talbott (CRD #1336628, Registered Principal, Peoria, Illinois)** submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Talbott reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Talbott consented to the described sanctions and to the entry of findings that he purchased, or caused to be purchased, \$45,000 in mutual fund shares in the accounts of public customers without the knowledge or consent of the customers and in the absence of written or oral authorization to Talbott to exercise discretion in the accounts.

Talbott's suspension began October 4, 2004, and will conclude at the close of business October 3, 2005. (NASD Case #C8A040035)

**Thomas Andrew Timberlake (CRD #870022, Registered Principal, Tampa, Florida)** was fined \$25,000, suspended from association with any NASD member for two years, and ordered to pay \$3,400 in restitution to public customers. The NAC imposed the sanctions following Timberlake's appeal of an OHO decision. The sanctions were based on findings that Timberlake made material misrepresentations and omissions in the offering of callable certificates of deposit (CDs) that he sold to public customers.

Timberlake's suspension began September 20, 2004, and will conclude at the close of business September 20, 2006. (NASD Case #C07010099)

**David William Trende (CRD #2725055, Registered Representative, Hinckley, Ohio)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Trende consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing written notices to his member firm. The findings also stated that Trende failed to receive written acknowledgement of the notices from his member firm prior to participation in the securities transactions.

Trende's suspension began October 18, 2004, and will conclude April 17, 2005. (NASD Case #C8A040081)

**Christopher Robin Van Dyk (CRD #1538653, Registered Principal, Bainbridge Island, Washington)** was barred from association with any NASD member in any capacity. The NAC imposed the sanction following call for review of an OHO decision by the NAC. The sanction was based on findings that Van Dyk participated in private securities transactions without prior written notice to, or approval from, his member firm to participate in the transactions. The findings also stated that Van Dyk failed to respond timely to NASD requests for information. (NASD Case #C3B020013)

**Anson Brian Walker (CRD #3244007, Registered Representative, Canton, Mississippi)** 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, Walker consented to the described sanction and to the entry of findings that he forged the signature of a public customer on a redemption form in an attempt to withdraw \$5,000 from the customer's securities account. The findings further stated that Walker submitted the fraudulent redemption form and caused an unauthorized liquidation of mutual fund shares in the customer's account

without the customer's knowledge or consent. (NASD Case #C05040069)

**James David Wedge (CRD #4635661, Associated Person, Phoenix, Arizona)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Wedge failed to respond to NASD requests for information or documents. The findings also stated that Wedge failed to disclose material information on his Form U4. (NASD Case #C3A040015)

**Donna Marie Weinstein aka Donna Marie Burch aka Donna Marie Ward (CRD #2054950, Registered Representative, Portland, Oregon)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Weinstein failed to disclose material information on her Form U4. (NASD Case #C3B040008)

**Jay Thaden Williams (CRD #3058968, Registered Representative, Burnsville, Minnesota)** submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Williams reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Williams consented to the described sanctions and to the entry of findings that he affixed the signatures of a public customer to insurance forms and checks in order to facilitate transactions on behalf of the customer without the customer's knowledge, authorization, and consent.

Williams' suspension began November 1, 2004, and will conclude April 30, 2005. (NASD Case #C04040042)

## 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.

**Dan Alan Camphausen (CRD #39460, Registered Representative, Chicago, Illinois)** was named as a respondent in an NASD complaint alleging that he effected purchases and sales of equity securities in the account of a public customer without the knowledge or consent of the customer and in the absence of written or oral authorization to exercise discretion in the account. (NASD Case #C8A040088)

**Izzeteen Hanif (CRD #1777495, Registered Representative, Mahwah, New Jersey)** was named as a respondent in an NASD complaint alleging that he recommended purchase and sell transactions to a public customer without having reasonable grounds for believing that such transactions were suitable for the customer in view of the nature of the recommended transactions, the costs associated with the transactions, and in light of the customer's financial situation, investment objectives, circumstances, and needs. (NASD Case #C9B040086)

**Investprivate, Inc. (CRD #103737, New York, New York) and Scott Lee Mathis (CRD #1362203, Registered Principal, New York, New York)** were named as respondents in an NASD complaint alleging that the firm, acting through Mathis, directly or indirectly, by the use of means or instrumentalities of interstate commerce, or of the mails, or of any facility of any national securities exchange, employed a device, scheme, contrivance, and artifice to defraud and manipulative, deceptive, or any other fraudulent devices or contrivances; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; engaged in acts, practices, or courses of business that operated as a fraud or deceit, or would operate as a fraud or deceit; and/or effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive devices or contrivances by knowingly or recklessly (1) distributing, or causing to be distributed, to investors or potential investors, through means of interstate commerce or the mails, private placement memoranda (PPM) that contained material misrepresentations or omissions, and (2) failing to supplement or amend the PPMs so that they did not contain material misrepresentations or omissions of fact that occurred after the PPMs were issued.

The complaint also alleges that the firm, acting through Mathis, offered and sold securities without registration statements having been filed with the SEC. The complaint further alleges that the firm, acting through Mathis, participated in the distribution of securities by acting as placement agent for private placements; failed to make filings with NASD containing an estimate of the maximum underwriting discount or commission that the firm anticipated receiving as a result of its participation, and any documents and information pertaining to the terms, conditions, and arrangements relating to the underwriting or distribution of shares; failed to receive an opinion of "no objections" from NASD to the proposed compensation and other terms, conditions, and arrangements; and participated in a public offering of securities in which the underwriting terms were unfair and unreasonable. In addition, the complaint alleges that Mathis willfully failed to amend his Form U4 and willfully failed to disclose material information on his Form U4.

Moreover, the complaint alleges that the firm failed to report a written customer complaint; failed to report timely a written customer complaint; and failed to report the settlement of customer complaints to NASD. The complaint further alleges that the firm and the individual failed to amend timely a Uniform Application for Broker-Dealer Registration (Form BD) disclosing a consent order with the Commonwealth of Massachusetts. In addition, the complaint alleges that the firm, acting through Mathis, permitted a person to engage in activity requiring registration as a general securities principal and general securities representative without obtaining the required registrations.

The complaint also alleges that the firm, acting through Mathis, failed to establish qualified escrow accounts on contingency offerings. Furthermore, the complaint alleges that the firm, acting through Mathis, failed to maintain its minimum net capital. In addition, the complaint alleges that the firm failed to preserve complete electronic mail communications by routinely deleting the contents of electronic mail folders of all employees who left the firm. The complaint alleges that the firm failed to implement, maintain, and enforce an effective supervisory system that would have enabled the firm to comply with federal securities laws and NASD rules, and failed to implement and maintain reasonable systems and procedures to ensure that PPMs did not contain material misrepresentations and omissions; that unregistered private placement offerings qualified for exemption from registration and that such exemptions were not destroyed; that the firm complied with NASD rules relating to corporate financing and conflicts of interest in distribution of securities of members and affiliates; that filings with NASD concerning customer complaints and state regulatory restrictions were made timely and accurately; that employees of the firm and its affiliates obtained all required NASD registrations; that the firm complied with the Net Capital Rule; that the accounts used for the deposit of contingency offerings conducted by the firm complied with SEC Rule 15c2-4; and that the firm retained e-mail records related to its business in compliance with NASD Rule 17a-4 of the Securities Exchange Act and NASD Rule 3110. (NASD Case C10040052)

**Edward Linzer (CRD #1050490, Registered Representative, Mineola, New York)** was named as a respondent in an NASD complaint alleging that he made material misrepresentations to public customers in connection with so-called "mortgage programs" in which the customers invested and incurred substantial losses. The complaint also alleges that Linzer misused the customers' funds in that he did not utilize the funds as he represented he would. In addition, the complaint alleges that Linzer failed to return the principal and interest that he promised he would repay to the customers. The complaint further alleged that Linzer failed to respond to NASD requests for documents and information, and to appear for an on-the-record interview. (NASD Case #CLI040027)

**James Patrick Smith (CRD #4473267, Registered Principal, Decatur, Illinois)** was named as a respondent in an NASD complaint alleging that he converted \$81,568.55 in funds intended for the purchase of traditional life insurance products or fixed annuities by public customers. The complaint also alleges that Smith deposited the funds into a checking account that he controlled and used the funds for his own purposes. (NASD Case #C8A040086)

**Samuel John Trigillo (CRD #1303837, Registered Representative, Spled, Illinois)** was named as a respondent in an NASD complaint alleging that he affixed the signature of a public customer on a transfer between accounts request and an annuity change request, changed the address for the customer's accounts to a post office box controlled by Trigillo, removed funds from a fixed annuity owned by the customer, and transferred the funds to a variable annuity with his member firm without the customer's knowledge or consent. The complaint further alleges that Trigillo affixed the signature of another registered representative on documents related to the transfer of accounts owned by public customers without the representative's knowledge or consent. In addition, the complaint alleges that Trigillo accepted \$84,307 in compensation from insurance companies for the sale of insurance policies to public customers and failed and neglected to provide prompt written notice to his member firm of his outside business activities. (NASD Case #C8A040082)

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

**E Street Access Securities, Inc.**  
Englishtown, New Jersey  
(October 7, 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.)

**Anderson, Rene C.**  
Palm Beach Gardens, Florida  
(August 5, 2004)

**Del Valle, Jose E.**  
Rio Piedras, Puerto Rico  
(August 5, 2004)

**Floyd, Brian C.**  
Orlando, Florida  
(September 17, 2004)

**Gray, Barry K.**  
West Columbia, South Carolina  
(September 23, 2004)

**Grist, Deborah L.**  
Chicago, Illinois  
(August 16, 2004)

**Gupta, Arvind K.**  
Flushing, New York  
(October 4, 2004)

**Hall, Nutashia**  
Kenneshaw, Georgia  
(October 4, 2004)

**Heimbach, Charles T.**  
Tampa, Florida  
(August 5, 2004)

**Ippolito, Anthony E.**  
Stockton, California  
(September 27, 2004)

**Regan, Jr., Henry Paul**  
Miami, Florida  
(August 3, 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.)

**Bridges, Thomas**  
Murphysboro, Illinois  
(October 8, 2004)

**Durney, William**  
Staten Island, New York  
(October 4, 2004)

**Henry, Ryan R.**  
Denver, Colorado  
(September 28, 2004)

**King, Jeffrey**  
Sellersberg, Indiana  
(September 17, 2004)

**McConnell, John M.**  
Shreveport, Louisiana  
(September 27, 2004)

**Shih-Hsieh, Darla Jade**  
Delray Beach, Florida  
(September 17, 2004)

**Styles, William D.**  
Santa Clara, Utah  
(September 23, 2004)

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

**Derrico, John J.**  
Farmingdale, New Jersey  
(October 7, 2004)

**Frankel, Alan**  
Merrick, New York  
(October 7, 2004)

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

**Maldonado, Kevin**  
Yonkers, New York  
(September 22, 2004)

**Parsons, David**  
Baldwin, New York  
(September 22, 2004)

**Default Decision Dismissed**

**Edwin Houston Hayes (CRD# 2398669)** On November 1, 2004, NASD's Office of Hearing Officers granted NASD's Department of Enforcement's motion to set aside the default decision rendered in NASD Case #C06030018 on December 3, 2003, which barred Mr. Hayes from associating with any NASD member in any capacity, and to dismiss the underlying complaint in that action. The initial sanction was based on findings that Hayes failed to respond to NASD requests for information. However, NASD was unaware that Hayes was on active military duty both at the time of the investigation and when NASD filed its complaint and its motion for default in 2003. **(NASD Case #C06030018)**

## **NASD Fines Citigroup Global Markets, Inc. \$250,000 In Largest Hedge Fund Sales Sanction To Date;**

### ***Sales Materials Included Unsubstantiated Claims, Inadequate Risk Disclosure***

In its largest enforcement action to date involving hedge fund sales by broker-dealers, NASD has censured and fined Citigroup Global Markets, Inc., \$250,000 for disseminating inappropriate sales literature. More than 100 pieces of sales literature distributed between July 1, 2002 and June 30, 2003, cited a targeted rate of return without providing a sound basis for evaluating the target, improperly used hypothetical returns in charts or graphs, and/or failed to include adequate risk disclosure. "As hedge funds and 'funds of hedge funds' are marketed more and more aggressively to individual investors, ensuring that those investors receive full and accurate information is critical," said NASD Vice Chairman Mary L. Schapiro. "This enforcement action underscores our commitment to making certain that firms provide the investing public with a sound basis for evaluating hedge fund investments, and adequately disclose all of the risks." Ninety-five of the pieces of sales literature contained targeted rates of return for particular funds but did not provide a sound basis for investors to evaluate the reasonableness of the stated target. Among the objectionable statements:

*"The Portfolio seeks to earn an annualized return of 15% or more, net of all fees, over a three- to five-year investment horizon, while maintaining volatility below that of world equities."*

*"...targets a 12-14% annual net return..."*

*"The portfolio seeks to earn an annualized return of LIBOR + 500 basis points."*

Twenty-eight of the sales pieces for recently started funds of hedge funds improperly presented hypothetical performance for these funds. This hypothetical performance showed results for the funds before they had begun operating, and therefore did not reflect the actual performance of the funds of hedge funds. Instead, these hypothetical results were calculated by selecting a portfolio of individual advisors with whom the fund of hedge funds intended to or had recently begun to invest, and then combining the historic performance results of these selected advisors, using a hypothetical allocation of assets.

Because it reflected the selection of potential advisors and asset allocations made after the performance of those advisors was already known, the hypothetical performance invariably showed positive rates of return. Further, there was no guarantee that the particular fund of hedge funds being promoted would continue to invest with any or all of the selected advisors—or that allocation of assets to those advisors would be the same as that used in the hypothetical performance.

In addition, in some instances, the sales literature presented hypothetical performance results in a chart or graph in combination with the actual historical performance of the fund of hedge funds. Such presentations created the misimpression that the particular fund of hedge funds had a longer investment track record than it actually possessed.

Forty-four pieces of sales literature failed to include adequate risk disclosure. Each of these pieces contained some risk disclosure, but not full and complete risk disclosure. Among the disclosures that were not included: that the funds are speculative and involve a high degree of risk; that an investor could lose all or a substantial amount of his or her investment; that there is no secondary market nor is one expected to develop for investments in the funds; that there may be restrictions on transferring fund investments; that the funds may be leveraged; that the funds' performance may be volatile; that the funds have high fees and expenses that would reduce returns; and other specific risks as to the particular funds' investments and strategies.

In settling this matter, Citigroup neither admitted nor denied the allegations, but consented to the entry of findings. As a result of a review of brokers and firms selling hedge funds and registered products (closed-end funds) that invest in hedge funds, NASD has become concerned that some may not be fulfilling their sales practice obligations, especially when selling and marketing these instruments to retail customers. NASD issued an Investor Alert in August 2002 (Funds Of Hedge Funds—Higher Costs And Risks For Higher Potential Returns) and a *Notice to Members* in February 2003 advising firms of their suitability obligation to investors whenever recommending or selling hedge funds ([www.nasdr.com/pdf-text/0307ntm.pdf](http://www.nasdr.com/pdf-text/0307ntm.pdf)). In addition, NASD has brought several enforcement actions against firms relating to their marketing and sales of hedge funds.