

AUGUST 2006

Notice to Members

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continued



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Disciplinary and Other NASD Actions

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Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Legal & Compliance
Trading
Registered Representatives
Senior Management

KEY TOPICS

Trading Activity Fee
NASDAQ Exchange Registration

GUIDANCE

Trading Activity Fee

Exemption for Registered NASDAQ Market Makers
Acting in the Capacity of Exchange Market Maker

Executive Summary

On July 5, 2006, The NASDAQ Stock Market, Inc. ("NASDAQ") announced that it would begin to operate as a national securities exchange on August 1, 2006 for NASDAQ-listed securities.¹ Section 1 of Schedule A to NASD's By-Laws exempts from the Trading Activity Fee ("TAF") proprietary transactions by a firm that is a member of both NASD and a national securities exchange, effected in its capacity as an exchange specialist or market maker, and that is subject to Securities Exchange Act of 1934, Section 11(a) and Rule 11a1-1(T)(a) thereunder. The exemption does not, however, apply to other transactions permitted by Section 11(a), such as *bona fide* arbitrage or hedge transactions.

Accordingly, on August 1, 2006 when NASDAQ became operational as an exchange in NASDAQ securities, NASD member firms that are also members of the NASDAQ Exchange became exempt from the TAF for transactions in which they act in their capacity as a registered market maker in such NASDAQ securities.² Further, when NASDAQ becomes operational as an exchange in Consolidated Quotation System ("CQS") securities on approximately October 1, 2006, NASD member firms that are also members of the NASDAQ Exchange will be exempt from the TAF for transactions effected on the NASDAQ Exchange in which they act in their capacity as a registered market maker in CQS securities.

Questions/Further Information

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

06-37

Background and Discussion

In 2003, the SEC approved NASD's new member regulatory pricing structure, which: (1) eliminated the NASDAQ-based regulatory fee; (2) instituted a new transaction-based TAF applied across a broader range of equity, options and securities futures transactions; (3) increased the rates assessed to member firms under the Personnel Assessment ("PA"); and (4) implemented a simplified three-tiered flat rate for the Gross Income Assessment ("GIA"), whereby deductions and exclusions were eliminated.³ NASD uses fees collected under the member regulatory pricing structure to fund member regulatory activities, including the regulation of members through examination, processing of membership applications, financial monitoring, policymaking, rulemaking, and interpretive and enforcement activities.

As stated above, Section 1 of Schedule A to NASD's By-Laws exempts from the TAF proprietary transactions by a firm that is a member of both NASD and a national securities exchange, effected in its capacity as an exchange specialist or market maker, and that is subject to Securities Exchange Act of 1934, Section 11(a) and Rule 11a1-1(T)(a) thereunder. Accordingly, once NASDAQ is operational as an exchange, this exemption will be applicable to transactions that occur on the NASDAQ Exchange in the same manner as it is currently applicable to certain transactions that occur on other exchanges. To assist members in understanding the application of this exemption to market making activity on the NASDAQ Exchange, NASD staff is publishing the following questions and answers.

Questions and Answers

1. Will a member be exempt for all proprietary transactions in NASDAQ-listed securities for which it is registered as a market maker?

No. Only those proprietary transactions effected through a registered market maker's quote on the NASDAQ Exchange are exempt from the TAF. Proprietary transactions of a registered market executed through SIZE on the NASDAQ Exchange are not exempt from the TAF, as well as transactions not effected through the NASDAQ Exchange like, for example, those reported to either a Trade Reporting Facility ("TRF")⁴ or the Alternative Display Facility ("ADF").⁵

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2. Does the exemption relating to registered NASDAQ Exchange market makers apply only to NASDAQ-listed securities?

Yes. Until NASDAQ is operational as an exchange in all National Market System (“NMS”) securities, the TAF exemption will apply only to NASDAQ-listed securities.⁶ NASDAQ has announced that it intends to be operational as an exchange in CQS securities on October 1, 2006. Accordingly, until NASDAQ is operating as a national securities exchange in CQS securities, transactions executed through NASDAQ systems in CQS securities are still subject to the TAF. At such time that NASDAQ is operational as an exchange in CQS securities, the TAF exemption discussed above for registered market makers acting in their capacity as a registered market maker on the NASDAQ exchange will also be applicable to CQS securities.

3. If I am a registered market maker on the NASDAQ Exchange and receive an agency order from an NASD member broker-dealer that I then send to the NASDAQ Exchange for execution, is that transaction exempt from the TAF?

Yes. Consistent with guidance issued in *Notice to Members 02-75*, Question 3, when a member acts as agent on behalf of another NASD member in the sale of a covered security, the fee will be assessed to the member who is the ultimate seller of the security, not the member acting as agent. Therefore, an agency transaction executed on behalf of another NASD member broker-dealer on the NASDAQ Exchange by a registered market maker acting in such capacity is exempt from the TAF.

4. If I am a registered market maker on the NASDAQ Exchange and receive an order from a customer that I send to the NASDAQ Exchange for execution, is that transaction exempt from the TAF?

No. Transactions executed on behalf of a registered market maker’s own customer, including agency and riskless principal transactions, must be assessed the TAF.

5. If I am a registered market maker on the NASDAQ Exchange and place an order in SIZE that is subsequently executed, is that transaction exempt from the TAF?

No. An execution resulting from an order, either agency or principal, placed into SIZE is not exempt from the TAF.

Endnotes

- 1 The Securities and Exchange Commission (“SEC”) approved NASDAQ’s application for registration as a national securities exchange on January 23, 2006. See Exchange Act Release No. 53128 (Jan. 13, 2006), 71 FR 3550 (Jan. 23, 2006) (File No. 10-131). On June 30, 2006, the SEC issued an order modifying a condition to NASDAQ’s operation as a national securities exchange. See Exchange Act Release No. 54085 (June 30, 2006), 71 FR 38910 (July 10, 2006) (File No. 10-131). NASDAQ plans to be operational as an exchange in NASDAQ-listed issues on August 1, 2006, and in other exchange-listed issues on or after September 1, 2006. See NASDAQ Head Trader Alert No. 2006-098 (July 5, 2006), <http://www.nasdaqtrader.com/trader/news/2006/headtraderalerts/hta2006-098.stm> and NASDAQ Head Trader Alert No. 2006-111 (July 26, 2006), <http://www.nasdaqtrader.com/Trader/News/2006/headtraderalerts/hta2006-111.stm>.
- 2 See, e.g. *Notice to Member 02-63* (Sept. 2002), Question 1.
- 3 See Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (approving SR-NASD-2002-148) and Exchange Act Release No. 47106 (Dec. 30, 2002), 68 FR 819 (Jan. 7, 2003) (approving SR-NASD-2002-99).
- 4 See Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (File No. SR-NASD-2005-087) (SEC approval of the changes to NASD rules to reflect NASDAQ’s registration as an exchange and the operation of the TRF by NASDAQ subject to NASD’s regulatory license and oversight).
- 5 See Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002) (SEC approval of SR-NASD-2002-97 authorizing NASD to operate the ADF on a pilot basis); Exchange Act Release No. 47633 (Apr. 10, 2003), 68 FR 19043 (Apr. 17, 2003) (File No. SR-NASD-2003-067) (extension of ADF pilot until January 26, 2004); Exchange Act Release No. 49131 (Jan. 27, 2004), 69 FR 5229 (Feb. 3, 2004) (File No. SR-NASD-2004-012) (extension of ADF pilot until October 26, 2004); Exchange Act Release No. 50601 (Oct. 28, 2004), 69 FR 64611 (Nov. 5, 2004) (File No. SR-NASD-2004-160) (extension of ADF pilot until July 26, 2005); Exchange Act Release No. 52122 (July 25, 2005), 70 FR (Aug. 1, 2005) (File No. SR-NASD-2005-092) (extension of ADF pilot until April 26, 2006); Exchange Act Release No. 53699 (April 21, 2006), 71 FR 25271 (Apr. 28, 2006) (File No. SR-NASD-2006-050) (extension of ADF pilot period until January 26, 2007).
- 6 See Exchange Act Release No. 51808 (June 5, 2005), 70 FR 37496 (June 29, 2005) (File No. S7-10-04) (SEC order adopting rules under Regulation NMS and amendments to the joint industry plans for disseminating market information).

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Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Internal Audit
Legal and Compliance
Retail
Senior Management

KEY TOPICS

Variable Life Settlements
Variable Insurance Policies
Suitability
Best Execution
Rule 3010

GUIDANCE

Life Settlements

Member Obligations with Respect to the Sale of Existing Variable Life Insurance Policies to Third Parties

Executive Summary

Sales of existing life insurance policies to third parties—often referred to as "life settlements"—have grown exponentially in recent years, and that trend appears likely to continue. The purpose of this *Notice* is to remind firms and associated persons that life settlements involving variable insurance policies are securities transactions, and firms and associated persons involved in such transactions are subject to applicable NASD rules.

Questions

Questions regarding this *Notice* may be directed to Eric Moss, Vice President and Director of Emerging Regulatory Issues, at (202) 728-8982; or Laura Gansler, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8275.

Background and Discussion

Until recently, the owner of a life insurance policy who no longer wanted or could not afford it had two options: to let it lapse or surrender it to the issuer for its cash surrender value. The emergence of a secondary market for existing life insurance policies provides a third alternative: to sell the policy to a third party for less than the net death benefit, but more than the cash surrender value. Such transactions are typically referred to as life settlements. The value of a particular life settlement depends on a variety of factors, including the insured's life expectancy and the nature and terms of the policy.

The life settlement market emerged as an offshoot of the viatical settlement industry that developed in the 1980s as a source of liquidity for AIDS patients and other terminally ill policyholders with life expectancies of less than two years. Unlike viaticals, however, life settlements involve policyholders who are not terminally ill, but generally have a life expectancy of between two and ten years. Life settlements also tend to involve policies with higher net death benefits than viaticals.

The life settlement market has expanded rapidly in recent years. One recent study estimates that existing policies with a collective face value of \$5.5 billion were sold by policyholders to investors in 2005, while others suggest that the potential market exceeds \$100 billion. Although business models vary, in a typical scenario, an insured sells an existing policy to a life settlement provider, which either holds it to maturity and collects the net death benefit, or sells the policy or interests in multiple, bundled policies to hedge funds or other investors. The insured may contact the life settlement provider directly, or through a financial adviser, or may use a life settlement broker, which solicits bids from multiple life settlement providers on behalf of the insured. In most states, both life settlement providers and life settlement brokers are subject to licensing and other requirements.

Most life settlement providers claim to target only those policyholders who have already made the decision to surrender a policy or allow it to lapse, either because the policy is no longer wanted or needed, or because the policyholder can no longer afford to pay the premiums. However, as more providers enter the life settlement industry, there is increasing competition to find policyholders who fall into that relatively narrow category. This has led some life settlement providers to aggressively encourage financial service providers, including broker-dealers, to canvass their books of business for seniors or other eligible customers who may be interested in selling their life insurance policies in the secondary market, even if they do not need to or had not previously considered surrendering or allowing their policies to lapse. Significantly, the commissions paid in connection with life settlements are typically quite high—in some cases, up to 30 percent or more of the purchase price. Accordingly, NASD is concerned that aggressive marketing tactics, fueled by high commissions, may lead to inappropriate sales practices in connection with these transactions.

Obligations under NASD Rules for Firms and Associated Persons When Recommending or Facilitating the Sale of an Existing Variable Life Insurance Policy to Third Parties

A variable life insurance policy is a security, and the sale of such a product in the secondary market is a securities transaction subject to NASD rules. The purpose of this *Notice* is to remind firms and associated persons of their obligations in connection with recommending or facilitating a variable life settlement, including suitability, due diligence, best execution, supervision and training, and compensation in connection with variable insurance contracts.

Suitability

NASD Rule 2310 requires that, before recommending the purchase, sale or exchange of a security, members must have a reasonable basis for believing that the transaction is suitable for the customer. This analysis requires an associated person to fully understand and explain to their customers the products and transactions they recommend. This analysis also requires an associated person to make reasonable efforts to obtain information concerning the customer's financial status, tax status, investment objectives and other relevant information.

NASD is concerned that some of the marketing materials prepared by life settlement companies to encourage financial service providers, including broker-dealers, to recommend life settlements to their customers do not present a fair and balanced view of life settlements, and may encourage broker-dealers to recommend unsuitable transactions.

A variable life settlement may be a valuable option for insureds who otherwise would surrender their policies or allow them to lapse. However, variable life settlements are not for everyone. There can be significant costs associated with such transactions, and NASD cautions firms that a variable life settlement is not necessarily suitable for a customer simply because the settlement price offered exceeds the policy's surrender value. Other relevant factors may include the customer's continued need for coverage, and, if the customer plans to replace the existing policy with another policy, the availability, adequacy and cost of comparable coverage. Depending on the circumstances, including the customer's stated financial needs and investment objectives, firms also may need to consider the basic tax and other relevant implications of selling a variable policy.¹

Due Diligence

In addition to the general due diligence regarding terms and conditions that is required in connection with any securities transaction, the unique nature of variable life settlements poses certain special concerns.² Purchasers of life settlements, whether they are life settlement providers, or the entities or investors who purchase interests in life settlements from them, commit to paying the premiums on the policy for the insured's lifetime in exchange for the net death benefit when the insured dies. Therefore, the sooner the insured dies, the more profitable the life settlement is to the purchaser. In sum, the purchaser acquires a financial interest in the insured's death.

While some states require that life settlement providers and brokers have confidentiality policies in place to protect the identity and the medical records of the insured, others do not. Likewise, some life settlement brokers only solicit bids from providers with such policies; others do not. Before recommending a life settlement to a customer, firms and associated persons should understand the confidentiality policies of the providers or brokers with whom they are doing business. They should also understand and be able to explain to their customers any ongoing obligations the customer will incur. For example, some life settlement providers require that the insured provide notification of significant medical developments.

Given the wide range of practices among industry participants, as well as the regulatory disparity among the states, firms that allow their associated persons to recommend variable life settlements may want to consider developing a list of approved life settlement providers and/or brokers whose policies and practices are consistent with the firms' obligations to its customers. At a minimum, NASD believes that firms should prohibit their associated persons from recommending variable life settlements that involve life settlement providers and brokers that are not properly licensed where such licenses are required.

Best Execution

Firms recommending or facilitating a variable life settlement must also make certain that they meet their best execution obligations under NASD Rule 2320. How that obligation is met in any given transaction depends on the particular facts and circumstances of the transaction, but the core duty is to use reasonable diligence first to ascertain the best market for the security, and then to obtain the most favorable price possible in that market under prevailing market conditions. Price is only one component of best execution. Other factors include the speed and quality of execution, and the reliability of the other market participants. Firms must develop their own policies and procedures for ensuring best execution in the context of variable life settlements. At a minimum, however, NASD believes that firms recommending that a customer sell a variable life insurance policy should make reasonable efforts to obtain bids from multiple licensed providers, either directly or through a life settlement broker.³ Therefore, an exclusivity arrangement between a firm or an associated person and one life settlement provider would generally be inconsistent with the firm's best execution obligations. Moreover, in a market that is evolving as rapidly as the life settlement market, firms should regularly review their best execution policies and procedures to ensure that they continue to satisfy Rule 2320.⁴

Training and Supervision

In accordance with NASD Rule 3010, members should establish an appropriate supervisory system to ensure that their associated persons comply with all applicable NASD and SEC rules when recommending or participating in the sale of variable life insurance policies in the secondary market. Among other things, firms must ensure that their written supervisory procedures require that the appropriate reasonable-basis suitability analysis is completed before transactions are recommended; associated persons perform appropriate customer-specific suitability analysis; all promotional materials are accurate and balanced; and all NASD and SEC rules are followed. In addition to establishing written procedures, firms also must document the steps they have taken to ensure adherence to these procedures.

Firms and associated persons should also remember that, pursuant to NASD Rule 3040, to the extent that an associated person participates in a settlement involving a variable life insurance policy outside the regular course or scope of the associated person's employment with a member, the associated person must provide prior written notice to the member describing the proposed transaction in detail. If the associated person is to

receive compensation in connection with the transaction, the member firm must approve in writing the associated person's participation in the transaction, must record it on the firm's books and records and must supervise the person's participation as if the transaction were executed on behalf of the member.

Compensation in Connection with Variable Insurance Contracts

NASD also reminds members that Rule 2820(g), governing the sale and distribution of variable contracts, prohibits an associated person from accepting any compensation from anyone other than the member with which the person is associated except in the manner specified by the rule. Members therefore should ensure that any compensation received by associated persons in connection with recommendations to sell a variable life insurance policy comports with this rule.

Participation in the Subsequent Marketing and Sale of Interests in Life Settlements

While this *Notice* focuses primarily on the obligations of NASD members and associated persons when recommending that a customer sell an existing variable life insurance policy to a third party, NASD is also concerned about the involvement of NASD members and associated persons in the subsequent marketing and sale of interests in life insurance policies for investment purposes. NASD notes that, depending on the circumstances, entities participating in the sale and marketing of interests in life insurance policies, variable or not, for investment purposes may trigger broker-dealer registration requirements under the Securities Exchange Act of 1934. NASD will continue to monitor this emerging market closely, and will take appropriate action or issue further guidance as necessary.

Endnotes

- 1 NASD notes that the sale of a variable policy, under certain circumstances, could have the unintended consequence of affecting the customer's eligibility for Medicaid or other federal programs
- 2 NASD has routinely reminded members about their due diligence obligations when recommending any securities transaction. See, e.g., *NASD Notice to Members 03-71: NASD Reminds Members of Obligations When Selling Non-Conventional Investments* (Nov. 2003).
- 3 If multiple bids from licensed providers are not available, firms may perform or obtain an actuarial valuation as a means to comport with their best execution responsibilities in terms of the price being offered.
- 4 For the sake of clarity, NASD reiterates that this *Notice* is aimed at the sale of existing variable life insurance policies by the insured to a third party, and nothing in the discussion of best execution obligations is meant to suggest that members are required to recommend the lowest-cost product when recommending the initial purchase of a variable insurance policy from an issuer.

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Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Finance
Legal & Compliance
Operations
Senior Management

KEY TOPICS

Away from the Market Sales
Odd-Lot Transactions
OTC Options
Regulatory Transaction Fee
Section 3 of Schedule A to
NASD By-Laws
Transaction Reporting

GUIDANCE

Automated Transaction Reporting

SEC Approves Amendments Relating to Automated Reporting of Transactions Subject to Regulatory Transaction Fee; **Effective Date: December 1, 2006**

Executive Summary

On June 12, 2006, the Securities and Exchange Commission (SEC) approved SR-NASD-2006-055 relating to automated reporting of transactions subject to the regulatory transaction fee under Section 3 of Schedule A to the NASD By-Laws (NASD Section 3).¹ Specifically, effective December 1, 2006, members will be required to report to NASD in an automated manner all transactions that must be reported to NASD and that are subject to a regulatory transaction fee pursuant to NASD Section 3. Members can use NASD systems, including the Trade Reporting Facility (TRF), OTC Reporting Facility (OTCRF) and/or the Alternative Display Facility Trade Reporting and Comparison Service (TRACS) to report such transactions to NASD in an automated manner.

NASD also has amended certain rules governing trade reporting that currently prohibit member firms from reporting odd-lot transactions, sales where the buyer and seller have agreed to a price substantially unrelated to the current market for the security (also referred to as "away from the market sales"), and purchases or sales of securities effected upon the exercise of an over-the-counter (OTC) option, as well as other transactions, to clarify that the prohibition found in the transaction reporting rules is limited to the submission of a transaction for publication purposes. Lastly, NASD has amended Rules 6130 and 6130A to require members to report odd-lot transactions, away from the markets sales, and OTC option exercises with a special indicator denoting that such transactions are reported in accordance with NASD Section 3. The amended rule text is set forth in Attachment A. As noted above, the effective date is December 1, 2006.

Questions/Further Information

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

Background and Discussion

Section 31 of the Securities Exchange Act of 1934 (Exchange Act) requires NASD and national securities exchanges to pay transaction fees and assessments to the SEC that are designed to recover the costs related to the government's supervision and regulation of the securities markets and securities professionals. NASD obtains its Section 31 fees and assessments from its membership in accordance with NASD Section 3. NASD Section 3 assessments apply only to transactions effected otherwise than on a national securities exchange.² Many of the transactions that are assessable under NASD Section 3 are reported to NASD through automated facilities. NASD is able to use the transaction data reported to these automated facilities for NASD Section 3 billing purposes.

Currently, member firms are required to self-report manually covered sales of odd-lots, away from the market sales and the exercise of OTC options because these transactions are not otherwise required to be reported to NASD through an automated facility. To improve NASD's programs related to compliance with Section 31 of the Exchange Act and Rule 31 thereunder, NASD is requiring members to report in an automated manner all covered securities transactions that must be reported to NASD and that are assessed under NASD Section 3. While the previous manual self-reporting process has allowed NASD to meet its obligations under Section 31 of the Exchange Act, automated reporting of such covered transactions will facilitate more efficient, accurate and timely reporting to the SEC. Automated reporting also will reduce the burden on members that results from manually reporting certain transactions to NASD.

Under the new provisions, odd-lot transactions, away from the market sales and OTC option exercises must be submitted to the TRF, OTCRF or TRACS, as applicable, by 6:30 p.m. Eastern Time on the day of execution (or the end of the reporting session that is in effect at that time) with a special indicator denoting that such transactions are reported in accordance with NASD Section 3. Specifically, all odd-lot transactions effected by a member otherwise than on a national securities exchange that are subject to a regulatory transaction fee pursuant to NASD Section 3, must be submitted with a modifier of .RO; away from the market sales effected by a member otherwise than on a national securities exchange that are subject to a regulatory transaction fee pursuant to NASD Section 3 must be submitted with a modifier of .RA; and OTC option exercises that are subject to a regulatory transaction fee pursuant to NASD Section 3 must be reported with a modifier of .RX. The transactions may be entered as clearing or non-clearing, as appropriate. These entries will not be assessed any system usage fees by TRF, OTCRF or TRACS, unless the entry is submitted for clearing, in which case the normal clearing related fee schedule will apply.

As of December 1, 2006, NASD will require the automated reporting of all transactions effected otherwise than on a national securities exchange that must be reported to NASD and that are subject to a regulatory transaction fee pursuant to NASD Section 3. As a result, members will no longer be required to file a Self-Reporting Form with NASD's Finance Department. This rule change only applies to NASD Section 3 assessable transactions executed on or after December 1, 2006. Any NASD Section 3 assessable transaction that is subject to the self-reporting requirement executed prior to that date should not be reported to TRF, OTCRF or TRACS for this purpose, but should be submitted on the Self-Reporting Form for the applicable month.

Endnotes

- 1 See Exchange Act Release No. 53977 (June 12, 2006), 71 FR 34976 (June 16, 2006) (Approval Order of File No. SR-NASD-2006-055).
- 2 On August 1, 2006, The Nasdaq Stock Market LLC began operation as a national securities exchange for purposes of NASDAQ-listed securities. Additionally, NASDAQ has announced it will become operational as an exchange for Consolidated Quotation System (CQS) securities on approximately October 1, 2006. Accordingly, NASD is reminding members that transactions executed on the NASDAQ exchange are not subject to NASD Section 3 and should not be reported to NASD pursuant to this rule change.

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ATTACHMENT A

Changes are shown against the current rule text. New language is underlined; deletions are in brackets.¹

* * * * *

SCHEDULE A TO NASD BY-LAWS

* * * * *

Section 3 — Regulatory Transaction Fee

Each member shall be assessed a regulatory transaction fee. The amount shall be determined periodically in accordance with Section 31 of the Act. Transactions assessable under this Section 3 that must be reported to NASD shall be reported in an automated manner.

* * * * *

4000. THE TRADE REPORTING FACILITY

* * * * *

4630. Reporting Transactions in Designated Securities

* * * * *

4632. Transaction Reporting

(a) through (d) No Change.

(e) Transactions Not [Required] To Be Reported For Publication Purposes

The following types of transactions shall not be reported to the Trade Reporting Facility for publication purposes:

(1) through (6) No Change.

(f) through (g) No Change.

¹ The rule text set forth in this attachment incorporates the amendments approved in SR-NASD-2006-055, as well as technical amendments that became effective pursuant to SR-NASD-2006-098.

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4000A. NASD ALTERNATIVE DISPLAY FACILITY

* * * * *

4600A. TRADING IN NASDAQ SECURITIES

* * * * *

4632A. Transactions Reported by Members

(a) through (j) No Change.

(k) Transactions Not To Be Reported To NASD For Publication Purposes

The following types of transactions effected by NASD members shall not be reported to TRACS for publication purposes:

(1) through (6) No Change.

(l) No Change.

* * * * *

6000. NASD SYSTEMS AND PROGRAMS

* * * * *

6100. CLEARING AND COMPARISON RULES

* * * * *

6130. Trade Report Input

(a) through (f) No Change.

(g) Reporting Certain Transactions for Purposes of Regulatory Transaction Fee Assessment

The following types of transactions that are assessed a regulatory transaction fee in accordance with Section 3 of Schedule A to the NASD By-Laws must be reported to the System as prescribed below. Transactions must be submitted to the System by 6:30 p.m. Eastern Time (or the end of the System reporting session that is in effect at that time).

(1) Odd-Lot Transactions

Transactions for less than a normal unit of trading shall be reported to the System with a modifier of .RO to designate the transaction as submitted for purposes of the regulatory transaction fee under Section 3 of Schedule A to the NASD By-Laws. Transactions may be entered as clearing or non-clearing.

(2) Away From the Market Sales

Transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security, and consideration is given, shall be reported to the System with a modifier of .RA to designate the transaction as submitted for purposes of the regulatory transaction fee under Section 3 of Schedule A to the NASD By-Laws. Transactions may be entered as clearing or non-clearing.

(3) Exercises of OTC Options

Transactions effected pursuant to the exercise of an OTC option shall be reported to the System with a modifier of .RX to designate the transaction as submitted for purposes of the regulatory transaction fee under Section 3 of Schedule A to the NASD By-Laws. Transactions may be entered as clearing or non-clearing.

* * * * *

6400. REPORTING TRANSACTIONS IN LISTED SECURITIES

* * * * *

6420. Transaction Reporting

(a) through (d) No Change.

(e) Transactions Not [Required] To Be Reported For Publication Purposes

The following types of transactions shall not be reported for inclusion on the Consolidated Tape:

(1) through (8) No Change.

(f) No Change.

* * * * *

6600. Over-The-Counter Equity Securities

* * * * *

6620. Transaction Reporting

(a) through (d) No Change.

(e) Transactions Not [Required] To Be Reported For Publication Purposes

The following types of transactions shall not be reported for publication purposes:

(1) through (4) No Change.

(f) No Change.

* * * * *

6000A. NASD ADF SYSTEMS AND PROGRAMS

* * * * *

6100A. TRACS TRADE COMPARISON SERVICE

* * * * *

6130A. Trade Report Input

(a) through (b) No Change.

(c) Reporting Certain Transactions for Purposes of Regulatory Transaction Fee Assessment

The following types of transactions that are assessed a regulatory transaction fee in accordance with Section 3 of Schedule A to the NASD By-Laws must be reported to TRACS as prescribed below. Transactions must be submitted to TRACS by 6:30 p.m. Eastern Time (or the end of the TRACS reporting session that is in effect at that time).

(1) Odd-Lot Transactions

Transactions for less than a normal unit of trading shall be reported to TRACS with a modifier of .RO to designate the transaction as submitted for purposes of the regulatory transaction fee under Section 3 of Schedule A to the NASD By-Laws. Transactions may be entered as clearing or non-clearing.

(2) Away From the Market Sales

Transactions where the buyer and seller have agreed to trade at a price substantially unrelated to the current market for the security, and consideration is given, shall be reported to TRACS with a modifier of .RA to designate the transaction as submitted for purposes of the regulatory transaction fee under Section 3 of Schedule A to the NASD By-Laws. Transactions may be entered as clearing or non-clearing.

(3) Exercises of OTC Options

Transactions effected pursuant to the exercise of an OTC option shall be reported to TRACS with a modifier of .RX to designate the transaction as submitted for purposes of the regulatory transaction fee under Section 3 of Schedule A to the NASD By-Laws. Transactions may be entered as clearing or non-clearing.

* * * * *

Special Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Operations
Registration
Senior Management

KEY TOPICS

District Elections

INFORMATIONAL

District Elections

Nominees for District Committee and District Nominating Committee

Executive Summary

The purpose of this *Special Notice to Members* is to announce the nominees for the District Committees and the District Nominating Committees.¹ The individuals identified in this *Special Notice* (see Attachment A) have been nominated for three-year terms² on the District Committees, and for one-year terms on the District Nominating Committees, starting in January 2007. These nominees will be considered duly elected on **September 1, 2006**, unless an election is contested in accordance with the procedures summarized below.

Also identified in Attachment A is the total number of candidates for the District Committee and/or the District Nominating Committee in each district. We appreciate the substantial interest shown by all of the candidates participating in the District Elections, and thank everyone for their continuing support of the self-regulatory process.

Contested Election Procedures

If an officer or director of, or individual who is registered with, an NASD member who meets the qualifications of Sections 8.2 or 8.9, as applicable, of the NASD Regulation By-Laws, has not been nominated by the District Nominating Committee as a candidate or alternate and wants to be considered for election to the District Committee or the District Nominating Committee, he or she must deliver a written notice to the District Director or Regional Director within 14 calendar days of the date of this *Special Notice*, or by **August 31, 2006**.

If an additional candidate or candidates come forward by **August 31, 2006**, the Corporate Secretary will provide each additional candidate with a list of members who are eligible to vote in the District. In order to be considered for nomination, within 30 calendar days of receipt of the list of members eligible to vote, an additional candidate must submit a petition to the District Nominating Committee with signatures from at least 10 percent of Executive Representatives of members eligible to vote in the District.

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

Questions/Further Information

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

Endnotes

1. In addition to nominating a slate of candidates for each of these committees, each District Nominating Committee may nominate one alternate candidate for each committee. The nomination of alternate candidates is permitted under Section 8.17 of the NASD Regulation By-Laws. Attachment A identifies each District Nominating Committee's slate of nominees, plus alternate candidates (if any).
2. Some nominees are filling existing vacancies and therefore may serve less than a three-year term, as indicated on Attachment A.

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ATTACHMENT A

District Committee and District Nominating Committee Nominees

District 1

Debra J. Pohlson, Acting District Director

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

(415) 882-1203

(415) 546-6991 Fax

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

2006 District Nominating Committee Chair

Nicholas C. Cochran

American Investors Company

San Ramon, CA

Number of Candidates: 23

District 1 Nominees

Leonard Berry

Backstrom McCarley Berry & Co., LLC

San Francisco, CA

Scott Cook

Charles Schwab & Co., Inc.

San Francisco, CA

James Williams

Financial Telesis, Inc.

San Rafael, CA

Alternate Candidate

Christopher Aguilar

Merriman Curhan Ford & Co.

San Francisco, CA

District 1 Nominating Committee Nominees

William A. Evans

Stone & Youngberg, LLC

San Francisco, CA

Gerard P. Gloisten

GBS Financial Corporation

Santa Rosa, CA

William P. Hayes

Wells Fargo Investments, LLC

San Francisco, CA

Francis X. Roche II

RBC Dain Rauscher, Inc.

San Francisco, CA

William Svoboda

Morgan Stanley

Palo Alto, CA

Alternate Candidate

Warren Gordon

Charles Schwab & Co., Inc.

San Francisco, CA

District 2

Lani M. Sen Woltmann, District Director

300 South Grand Avenue, Suite 1600, Los Angeles, CA 90071-3126

(213) 613-2601

(213) 617-3156 Fax

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

2006 District Nominating Committee Chair

Don Dalis

UBS Financial Services, Inc.

Newport Beach, CA

Number of Candidates: 28

District 2 Nominees

Benjamin J. Prince

Banc of America Investment Services

Newport Beach, CA

Jeffrey P. Shackett

RH Investment Corp.

Encino, CA

Craig R. Watanabe

Western International Securities

Pasadena, CA

Alternate Candidate

Maureen M. Maloney

Associated Securities Corp.

Los Angeles, CA

District 2 Nominating Committee Nominees

M. LaRae Bakerink

WBB Securities, LLC

San Diego, CA

Stephen B. Benton

Financial Network Investment Corp.

El Segundo, CA

Don S. Dalis

UBS Financial Services, Inc.

Newport Beach, CA

James M. Dillahunty

Fixed Income Securities, LLC

San Diego, CA

Neal E. Nakagiri

NPB Financial Group, LLC

Burbank, CA

Alternate Candidate

Diane P. Blakeslee

Blakeslee & Blakeslee, Inc.

San Luis Obispo, CA

District 3

Joseph M. McCarthy, District Director

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

(303) 446-3100

(303) 620-9450 Fax

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

Michael E. Lewis, District Director

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

(206) 624-0790

(206) 623-2518 Fax

Alaska, Idaho, Montana, Oregon and Washington

2006 District Nominating Committee Chair

Bridget M. Gaughan

AIG Financial Advisors, Inc.

Phoenix, AZ

Number of Candidates: 28

District 3 Nominees

James Cannon

AIG Financial Advisors, Inc.

Phoenix, AZ

Patrick Elliott

RBC Dain Rauscher

Bainbridge Island, WA

Chester Hebert

CIM Securities, LLC

Greenwood Village, CO

Alternate Candidate

Elyssa Baltazar

Citigroup Global Markets, Inc.

Denver, CO

District 3 Nominating Committee Nominees

Bridget Gaughan

AIG Financial Advisors, Inc.

Phoenix, AZ

John Goodwin

Goodwin Browning & Luna Securities, Inc.

Albuquerque, NM

Curtis Hammond

Morgan Stanley DW Inc.

Bellevue, WA

J. Keith Kessel

AFS Brokerage, Inc.

Greenwood Village, CO

Arlene Wilson

D.A. Davidson

Great Falls, MT

District 4

Thomas D. Clough, District Director

120 W. 12th Street, Suite 800, Kansas City, MO 64105

(816) 421-5700

(816) 421-5029 Fax

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

2006 District Nominating Committee Chair

Jeffrey A. Schuh Residential Funding Securities Corporation Minneapolis, MN

Number of Candidates: 33

District 4 Nominees

Kenneth M. Cherrier ¹	Fintegra, LLC	Minneapolis, MN
Richard D. Link	Edward Jones	St. Louis, MO
Daniel J. May	Financial Network Investment Corporation	Minneapolis, MN
Arthur S. Montgomery ²	Walnut Street Securities, Inc.	St. Louis, MO

Alternate Candidate

Jo Ann Zellmer	Northland Securities, Inc.	Minneapolis, MN
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District 4 Nominating Committee Nominees

Robert M. Chambers	A.G. Edwards & Sons, Inc.	West Des Moines, IA
Joseph D. Fleming	RBC Dain Rauscher Inc.	Minneapolis, MN
Mark T. Lasswell	Wells Fargo Brokerage Services, LLC	Minneapolis, MN
Kevin P. Maas	PrimeVest Financial Services, Inc.	St. Cloud, MN
Stephen S. Soden	Country Club Financial Services, Inc.	Mission Woods, KS

- 1 Mr. Cherrier has been nominated to serve the remaining year of the term of Stephen R. Oliver, who has resigned from the District Committee.
- 2 Mr. Montgomery is currently serving the remaining year of the term of Richard M. Hurwitz, who resigned from the District Committee. Mr. Montgomery has been nominated to serve a three-year term on the District Committee, commencing January 2007.

District 5

Keith E. Hinrichs, District Director

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

(504) 522-6527

(504) 522-4077 Fax

Alabama, Arkansas, Louisiana, Mississippi, Oklahoma and Tennessee

2006 District Nominating Committee Chair

John J. Dardis

Jack Dardis & Associates, Ltd.

Metairie, LA

Number of Candidates: 27

District 5 Nominees

Hal J. Brown

BOSC, Inc.

Oklahoma City, OK

Michael J. Mungenast

ProEquities, Inc.

Birmingham, AL

Gary K. Wunderlich, Jr.

Wunderlich Securities, Inc.

Memphis, TN

Alternate Candidate

Rush F. Harding, III

Crews & Associates, Inc.

Little Rock, AR

District 5 Nominating Committee Nominees

John J. Dardis

Next Financial Group, Inc.

Metairie, LA

Henry M. Fyfe, III

Duncan-Williams, Inc.

Memphis, TN

Charles C. Hollinger, Jr.

Johnson Rice & Company, LLC

New Orleans, LA

Carolyn R. May

Simmons First Investment Group, Inc.

Little Rock, AR

R. Patrick Shepherd

Avondale Partners, LLC

Nashville, TN

Alternate Candidate

Donald (Don) Winton

Crews & Associates, Inc.

Little Rock, AR

District 6

Virginia F. M. Jans, Regional Director, South Region

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

(972) 701-8554

(972) 716-7646 Fax

Texas

2006 District Nominating Committee Chair

V. Keith Roberts	Stanford Group Company	Houston, TX
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Number of Candidates: 33

District 6 Nominees

Kennard (Ken) R. George	VSR Financial Services, Inc.	Dripping Springs, TX
William C. Rea	Banc of America Investment Services, Inc.	Dallas, TX
Fenner R. Weller, Jr.	Weller Anderson & Co., Ltd.	Houston, TX

Alternate Candidate

Joan H. (Dorothy) Peurifoy	Financial Network Investment Corporation	Dallas, TX
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District 6 Nominating Committee Nominees

Karen Banks	Frost Brokerage Services, Inc.	San Antonio, TX
Cynthia E. Besek	Maplewood Investment Advisors, Inc.	Dallas, TX
William D. Felder	Southwest Securities, Inc.	Dallas, TX
Brent T. Johnson	Multi-Financial Securities Corporation	Houston, TX
John R. Muschalek	First Southwest Company	Dallas, TX

Alternate Candidate

Sennett Kirk, III	Kirk Securities Corporation	Denton, TX
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District 7

Daniel J. Stefek, District Director

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

(404) 239-6128

(404) 237-9290 Fax

Georgia, North Carolina and South Carolina

Mitchell C. Atkins, District Director

Crystal Corporate Center
2500 N. Military Trail, Suite 302
Boca Raton, FL 33431

(561) 443-8010

(561) 443-7995 Fax

*Florida, Puerto Rico, the Canal Zone and
the Virgin Islands*

2006 District Nominating Committee Chair

Roark A. Young

Young, Stovall & Company

Miami, FL

Number of Candidates: 37

District 7 Nominees

Jed E. Bandes	Mutual Trust Company of America Securities	Clearwater, FL
Valerie G. Brown	Multi-Financial Services Corporation	Atlanta, GA
Raymond H. Smith, Jr. ³	Smith, Brown & Groover, Inc.	Macon, GA
Dennis W. Zank	Raymond James & Associates, Inc.	St. Petersburg, FL

Alternate Candidate

Thomas A. Kicak	SunTrust Capital Markets, Inc.	Atlanta, GA
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District 7 Nominating Committee Nominees

Susan J. Hechtlinger	Banc of America Investment Services, Inc.	Charlotte, NC
Landrum H. Henderson, Jr.	Stephens, Inc.	Charlotte, NC
Dennis S. Kaminski	Mutual Service Corporation	West Palm Beach, FL
James A. Klotz	FMSBonds, Inc.	North Miami Beach, FL
Alan L. Maxwell	Wachovia Capital Markets, LLC	Charlotte, NC

Alternate Candidate

Kenneth W. McGrath	Popular Securities, Inc.	San Juan, PR
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³ Mr. Smith has been nominated to serve the remaining year of the term of Erick R. Holt, who has resigned from the District Committee.

District 8

Carla A. Romano, Regional Director, Midwest Region

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

(312) 899-4324

(312) 899-4399 Fax

Illinois, Indiana, Kentucky, Michigan, Ohio and Wisconsin

2006 District Nominating Committee Chair

Carol P. Foley

Podesta & Company

Chicago, IL

Number of Candidates: 47

District 8 Nominees

Joel R. Blumenschein

Freedom Investors Corp.

Hartland, WI

Thomas A. Bono

David A. Noyes & Company

Oak Park, IL

Steven J. Greenwald

Telemus Investment Brokers, LLC

Southfield, MI

Alternate Candidate

Lloyd A. Wennlund

Northern Trust Securities, Inc.

Chicago, IL

District 8 Nominating Committee Nominees

George E. Bates

Bates Securities, Inc.

Rockford, IL

Michael E. Bosway

City Securities Corporation

Indianapolis, IN

Mari Buechner

Coordinated Capital Securities, Inc.

Madison, WI

Ruth C. Hannenberg

Mesirow Financial, Inc.

Chicago, IL

Robert J. Michelotti

Ferris, Baker Watts Incorporated

Auburn Hills, MI

Alternate Candidate

G. Donald Steel

Planned Investment Co., Inc.

Indianapolis, IN

District 9

Gary K. Liebowitz, Regional Director, North Region

581 Main Street, 7th Floor
Woodbridge, NJ 07095

(732) 596-2025

(732) 596-2001 Fax

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

James J. Flicker, Associate District Director

1835 Market Street, Suite 1900
Philadelphia, PA 19103

(215) 665-1180

(215) 963-7442 Fax

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

2006 District Nominating Committee Chair

Michael B. Row

Pershing LLC

Jersey City, NJ

Number of Candidates: 28

District 9 Nominees

Wayne F. Holly⁴

Sage, Ruty & Co., Inc.

Rochester, NY

James J. Rabenstine

PNC Investments LLC

Pittsburgh, PA

Timothy L. Smith

Comprehensive Asset Management & Servicing, Inc.

Parsippany, NJ

Alternate Candidate

James Clements

Park Avenue Securities LLC

Bethlehem, PA

District 9 Nominating Committee Nominees

A. Louis Denton

Peterson Investments, Inc.

Blue Bell, PA

Peter P. Jenkins

Credit Suisse Securities (USA) LLC

Baltimore, MD

W. Dean Karrash

Burke, Lawton, Brewer & Burke

Spring House, PA

Gregg A. Kidd

Pinnacle Investments Inc.

East Syracuse, NY

Harold N. Peremel

Mercantile Brokerage Services, Inc.

Baltimore, MD

Alternate Candidate

Kimberly Tillotson Fleming

Hefren-Tillotson, Inc.

Pittsburgh, PA

⁴ Mr. Holly is currently serving the remaining year of the term of Barry M. Cash, who resigned from the District Committee. Mr. Holly has been nominated to serve a three-year term on the District Committee, commencing January 2007.

District 10

Hans L. Reich, Regional Director, New York Region

One Liberty Plaza
49th Floor, 165 Broadway
New York, NY 10006

(212) 858-4180

(212) 858-4078 Fax

Patricia Cappeto, Deputy District Director Long Island Office

Two Jericho Plaza
2nd Floor, Wing A
Jericho, NY 11753

(516) 949-4200

(516) 949-4201 Fax

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

2006 District Nominating Committee Chair

Jennifer A. Connors

Lehman Brothers Inc.

New York, NY

Number of Candidates: 23

District 10 Nominees

Alfred R. Berkeley, III	Pipeline Trading Systems LLC	New York, NY
Kathryn G. Casparian	CIBC World Markets Corp.	New York, NY
Jonathan S. Hurd	Terwin Capital, LLC	New York, NY
Craig B. Jampol ⁵	Caris & Company	New York, NY
James D. Lamke	Bear, Stearns & Co. Inc.	New York, NY

Alternate Candidate

George Mandl	ITG Inc.	New York, NY
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District 10 Nominating Committee Nominees

Margaret M. Caffrey	Schonfeld & Company, LLC	Jericho, NY
Lon T. Dolber	American Portfolios Financial Services, Inc.	Holbrook, NY
George T. Mimura	Nomura Securities International, Inc.	New York, NY
Richard J. Paley	Carey Financial Corporation	New York, NY
Howard R. Plotkin	Lehman Brothers Inc.	New York, NY

Alternate Candidate

Judith R. MacDonald	Rothschild Inc.	New York, NY
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⁵ Mr. Jampol has been nominated to serve the remaining year of the term of Jeffrey T. Letzler, who has resigned from the District Committee.

District 11

Frederick F. McDonald, Jr., District Director

99 High Street, Suite 900, Boston, MA 02110

(617) 532-3401

(617) 451-3524 Fax

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

2006 District Nominating Committee Chair

Mark R. Hansen

Alta Capital Group, LLC

Boston, MA

Number of Candidates: 21

District 11 Nominees

Michael E. Callaghan

Harvest Capital Advisors, LLC

Wethersfield, CT

Stephen L. Schardin

Charles River Brokerage, LLC

Burlington, MA

Therese M. Squillacote

ING Financial Advisers, LLC

Hartford, CT

Alternate Candidate

Steven D. Martino

Detwiler, Mitchell, Fenton, and Graves, Inc.

Boston, MA

District 11 Nominating Committee Nominees

David K. Booth

Jefferson Pilot Securities Corp.

Concord, NH

Mark R. Hansen

Alta Capital Group, LLC

Boston, MA

Thomas F. Hollenbeck

National Financial Services, LLC

Boston, MA

Thomas J. Horack

Sun Life Financial Distributors

Wellesley Hills, MA

Wilson G. Saville

Barrett & Company

Providence, RI

Alternate Candidate

Curtis L. Snyder, Jr.

American Technology Research, Inc.

Greenwich, CT

Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Legal & Compliance
Operations
Senior Management

KEY TOPICS

Anti-Money Laundering

INFORMATIONAL

NASD and NYSE Joint Release on Section 311 of the USA PATRIOT Act Special Measures against Specified Banks Pursuant to Section 311 of the USA PATRIOT Act

Discussion

This *Notice* reminds member organizations that the Financial Crimes Enforcement Network (FinCEN) has issued a final rule imposing a special measure,¹ which becomes effective August 14, 2006, against the Latvian bank VEF Banka and its subsidiaries, including Veiksmes līzings.² This measure is comparable to that imposed against the Commercial Bank of Syria and its subsidiaries, including Syrian Lebanese Commercial Bank, which became effective April 14, 2006.³

The special measures have been imposed in response to findings that these entities and their subsidiaries (the "Specified Banks") are financial institutions of primary money laundering concern. Under the special measures, covered financial institutions, which includes broker-dealers, are subject to the following two primary requirements with respect to the Specified Banks:

Prohibition of the Direct Use of Correspondent Accounts by the Specified Banks

Covered financial institutions are prohibited from opening or maintaining a correspondent account⁴ in the United States for, or on behalf of, the Specified Banks. This prohibition requires all covered financial institutions to review their account records to ensure that they maintain no accounts directly for, or on behalf of, the Specified Banks.

Due Diligence to Prevent Indirect Use

As a corollary to the prohibition on the opening or maintaining of correspondent accounts directly for the Specified Banks, each covered financial institution is required to apply due diligence to its correspondent accounts that is reasonably designed to guard against their indirect use by the Specified Banks. At a minimum, such due diligence must include two elements:

1) Notification to Correspondent Accountholders

A covered financial institution must notify its correspondent accountholders that the account may not be used to provide the Specified Banks with access to the covered financial institution. The purpose of the notice requirement is to help ensure that the Specified Banks are denied access to the United States financial system, as well as to increase awareness within the international financial community of the risks and deficiencies of the Specified Banks. However, the final rules emphasize that FinCEN is not requiring or expecting financial institutions to obtain a certification from their correspondent accountholders that indirect use will not be provided.

Although FinCEN makes clear that covered financial institutions have flexibility in choosing their method of notification, sample notification language which may be used for this purpose is provided, as follows:

“Notice: Pursuant to U.S. regulations issued under section 311 of the USA PATRIOT Act, 31 CFR 103.192, we are prohibited from opening or maintaining a correspondent account for, or on behalf of, [the Specified Banks]. The regulations also require us to notify you that your correspondent account with our financial institution may not be used to provide [the Specified Banks] with access to our financial institution. If we become aware that [the Specified Banks] are indirectly using the correspondent account you hold at our financial institution, we will be required to take appropriate steps to prevent such access, including terminating your account.”

Methods of compliance with the notice requirement could include, for example, transmitting a one-time notice by mail, fax, or e-mail, or including such information in the next regularly occurring transmittal from the covered financial institution to its correspondent accountholders. Each covered financial institution must document its compliance with the requirement that it notify its correspondent accountholders that the accounts may not be used to provide the Specified Banks with access to the covered financial institution.

2) Identification of Indirect Use

A covered financial institution must take reasonable steps in order to identify any indirect use of its correspondent accounts by the Specified Banks, to the extent that such indirect use can be determined from transactional records maintained by the covered financial institution in the normal course of business. A covered financial institution must take a risk-based approach when deciding what, if any, additional due diligence measures it should adopt to guard against the indirect use of correspondent accounts by the Specified Banks, based on risk factors such as the type of services offered by, and geographic locations of, its correspondents. Unlike the duties imposed under the one-time notification requirement, covered financial institutions have an ongoing obligation to take reasonable steps to identify all correspondent account services they may directly or indirectly provide to the Specified Banks.

Members are urged to consult the following links for further details:

- www.fincen.gov/vef_final_rule_070706.pdf (for additional information regarding the final rule issued against VEF Banka and its subsidiaries);
- www.fincen.gov/noticeoffinalrule03152006.pdf (for additional information regarding the final rule issued against the Commercial Bank of Syria and its subsidiary, Syrian Lebanese Commercial Bank); and
- www.fincen.gov/reg_section311.html (for information on all special measures issued by FinCEN).

Questions/Further Information

Questions or comments concerning this *Notice* may be directed as follows:

NASD: Brant K. Brown, Assistant General Counsel, Regulatory Policy and Oversight, at (202) 728-6927.

NYSE: Stephen Kasprzak, at (212) 656-5226.

Endnotes

- 1 The rule was issued pursuant to the authority contained in 31 U.S.C. § 5318A. Section 311 of the USA PATRIOT Act added section 5318A to the Bank Secrecy Act and granted the Secretary of the Treasury the authority, after finding that reasonable grounds exist for concluding that a foreign jurisdiction, foreign financial institution, international class of transactions, or type of account is of “primary money laundering concern,” to require domestic financial institutions and domestic financial agencies to take certain “special measures” against the primary money laundering concern.
- 2 See 71 FR 39554 (July 13, 2006) available at www.fincen.gov/vef_final_rule_070706.pdf.
- 3 See 71 FR 13265 (Mar. 15, 2006) available at www.fincen.gov/noticeoffinalrule03152006.pdf.
- 4 For purposes of these final rules, a “correspondent account” is defined as an account established to receive deposits from, or make payments or other disbursements on behalf of, a foreign bank, or handle other financial transactions related to the foreign bank (see 31 U.S.C. § 5318A(e)(1)(B) as implemented in 31 C.F.R. § 103.175(d)(1)(ii)).

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Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Legal and Compliance
Senior Management
Operations
Systems
Trading

KEY TOPICS

Alternative Display Facility
IM-4613A-1
Multiple Market Participant
Identifiers
Registered Reporting ADF ECNs
Rule 4613A

GUIDANCE

Alternative Display Facility

Pilot Program to Permit Additional Market Participant Identifier Functionality on the Alternative Display Facility

Executive Summary

On August 8, 2006, NASD filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a rule change to amend Rule 4613A and adopt IM-4613A-1 to enable ECN members that post quotations through the Alternative Display Facility (ADF) (*i.e.*, Registered Reporting ADF ECNs) to request and receive multiple market participant identifiers (MPIDs) with which to enter multiple quotes/orders in the ADF and report trades through the ADF Trade Reporting and Comparison Service (TRACS), pursuant to the Rule 4000A Series.¹

Rule 4613A, as amended, and new IM-4613A-1 are set forth in Attachment A of this *Notice*. The effective date and the implementation date of the amendments was August 8, 2006.

Questions/Further Information

Questions regarding this *Notice* may be directed to Elliot Levine, Associate Vice President, Transparency Services, at (202) 728-8405; Chris Stone, Associate Chief Counsel, Transparency Services, at (202) 728-8457; or Kathleen O'Mara, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8056.

Background and Discussion

An NASD member that registers as a market maker or ECN is currently permitted to enter one two-sided quotation per security in the ADF and is assigned a unique MPID with which to enter such quotations. The NASD 4600A Rule Series governs the character of such quotations and the rights and obligations of members that display quotations in the ADF via their MPIDs.

NASD has amended Rule 4613A and adopted IM-4613A-1 to permit Registered Reporting ADF ECNs to request the use of additional MPIDs for a pilot period ending January 26, 2007.² At this time, only ECNs have been certified for posting quotations through the ADF, and at no time has a registered market maker been certified for the ADF. Accordingly, the scope of this rule is limited to Registered Reporting ADF ECNs.³ An ECN will be entitled to request additional MPIDs for displaying quotes/orders and reporting trades through the ADF trade reporting facility, TRACS, pursuant to the Rule 4000A Series.⁴

Registered Reporting ADF ECNs that are permitted to use an additional MPID for displaying quotes/orders are subject to the same rules applicable to the members' first quotation. In other words, ECNs that display one or more additional quotes/orders are required to comply with all NASD and SEC rules applicable to ECNs in their display of quotes/orders. Registered Reporting ADF ECNs are prohibited from using an additional MPID to accomplish indirectly what they are prohibited from doing directly through their Primary MPID. To the extent that the allocation of additional MPIDs were to create regulatory confusion or ambiguity or would diminish the quality or rigor of the regulation of the over-the-counter market, every inference would be drawn against the use of additional MPIDs. Moreover, pursuant to the rule and related interpretive material, NASD staff has full discretion to determine whether a bona fide regulatory and/or business need exists for being granted the additional MPID privilege and to limit or withdraw the additional MPID display privilege at any time.

The amendments to Rule 4613A and IM-4613A-1 became effective August 8, 2006.

Endnotes

- 1 Exchange Act Release No. 54307 (August 11, 2006) (Notice of Filing and Immediate Effectiveness of SR-NASD-2006-096). Under Section 19(b) of the Securities Exchange Act of 1934 (Act), the SEC has the authority to summarily abrogate this type of rule change within 60 days of filing.
- 2 This date coincides with the expiration of the current ADF pilot period. See Exchange Act Release No. 53699 (April 21, 2006). Accordingly, the provisions set forth in Rule 4613A and IM-4613A-1 will be extended with any extension of an ADF pilot period.
- 3 NASD will expand additional MPID privilege functionality to Registered Reporting ADF Market Makers at such time that at least one broker-dealer NASD member becomes certified for posting quotations through the ADF and demonstrates a bona fide business and/or regulatory need for additional MPID functionality.
- 4 NASD will not assess fees for the issuance or use of an additional MPID, other than the SEC-approved fees set forth in NASD Rule 7010.

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ATTACHMENT A

New language is underlined.

* * * * *

4613A. Character of Quotations

(a) No Change.

(b) Primary and Additional MPIDs

(1) The first Market Participant Identifier ("MPID") issued to an NASD Market Participant shall be referred to as the NASD Market Participant's "Primary MPID." For a pilot period ending January 26, 2007, a Registered Reporting ADF ECN may request the use of Additional MPIDs for displaying quotes/orders and reporting trades through TRACS for any ADF-Eligible Security (as defined in NASD Rule 4100A). A Registered Reporting ADF ECN that ceases to meet the obligations appurtenant to its Primary MPID in any security shall not be permitted to use Additional MPIDs for any purpose in that security.

(b) through (e) renumbered as (c) through (f).

* * * * *

IM-4613A-1 Procedures For Allocation of Multiple MPIDs

NASD considers the issuance of, the display of, and the trade reporting with Additional MPIDs to be a privilege and not a right. NASD has developed the following method for allocating the privilege of receiving, displaying, and trade reporting with Additional MPIDs in an orderly, predictable, and fair manner. While NASD does not intend to place a numerical limit on the number of Additional MPIDs it may grant to Registered Reporting ADF ECNs, given the agent business model of ECNs, NASD does not anticipate the granting of many additional MPIDs to Registered Reporting ADF ECNs.

As described in Rule 4613A, NASD will automatically designate a Registered Reporting ADF ECN's first MPID as a "Primary MPID." Additional MPIDs will be designated as such. Registered Reporting ADF ECNs are required to use their Primary MPID in accordance with the requirements of NASD Rule 4613A as well as all existing requirements for the use of MPIDs in NASD systems and under NASD rules. Each of an ECN's MPID will be subject to the requirements of NASD Rule 4623A.

If it is determined that one or more Additional MPIDs are being used improperly, NASD staff retains full discretion to limit or withdraw its grant of the Additional MPID(s) for all purposes for all securities. In addition, if a Registered Reporting ADF ECN no longer fulfills the conditions appurtenant to its Primary MPID (e.g., by being placed into an unexcused withdrawal), it may not use an Additional MPID for any purpose in that security.

The first priority of NASD's method for allocating the privilege of displaying and trade reporting with Additional MPIDs is that each Registered Reporting ADF ECN should be permitted to display quotations and report trades under a Primary MPID before any is permitted to display additional quotations under and report trades with Additional MPIDs. If all requests for Primary MPIDs have been satisfied, NASD will then register Additional MPIDs on a first-come-first-served basis, consistent with the procedures listed below.

A Registered Reporting ADF ECN shall contact NASD in writing setting forth the bona fide business and/or regulatory reasons for requesting an Additional MPID. NASD will consider the business and/or regulatory reasons demonstrated by the Registered Reporting ADF ECN and promptly respond to the Registered Reporting ADF ECN. If an Additional MPID is granted, it will be subject to the same requirements applicable to a Primary MPID. NASD staff retains full discretion to limit or withdraw the Additional MPID privileges of a Registered Reporting ADF ECN.

A Registered Reporting ADF ECN that posts a quotation through either a Primary MPID or Additional MPID and reports a trade to TRACS as a result of such a posted quotation must utilize the corresponding Primary MPID or Additional MPID for reporting purposes through which the quotation was originally posted (i.e., Registered Reporting ADF ECNs must use the same MPID for TRACS trade reporting as was used for ADF quotation posting).

* * * * *

Special Notice to Members

AUGUST 23, 2006

SUGGESTED ROUTING

Legal & Compliance
Senior Management

KEY TOPICS

National Adjudicatory Council

INFORMATIONAL

NAC Nominees

NASD Announces Nominees for Regional Industry Member Seats on the National Adjudicatory Council

Executive Summary

The purpose of this *Special Notice to Members* is to announce the proposed nominees for the National Adjudicatory Council (NAC) from the New York and West Regions. The nominees, nominated for three-year terms beginning January 2007, are listed in Exhibit 1. The nominees will be proposed to NASD's National Nominating Committee unless an additional candidate comes forward within 14 calendar days from the date of this *Special Notice*.

We appreciate the interest shown by many members in expressing their desire to serve on the NAC, and thank everyone for their continuing support of the self-regulatory process. The New York and West Regional Nominating Committees thoroughly reviewed the background of every candidate before selecting their nominees in an effort to secure appropriate and fair representation of both regions.

Contested Election Procedures

If an officer, director or employee of an NASD member in the New York and West Regions has not been proposed for nomination by the Regional Nominating Committee and wants to seek the nomination, he or she should send a written notice to Barbara Z. Sweeney, NASD's Corporate Secretary, at the address below within 14 calendar days of the date of this *Special Notice*, or by **September 6, 2006**.

Barbara Z. Sweeney
NASD
Office of the Corporate Secretary
1735 K Street, NW
Washington, DC 20006-1506

The Contested Nomination Procedures can be found in Article VI of the NASD Regulation By-Laws. If no additional candidate comes forward within 14 calendar days, the New York and West Regional Nominating Committees shall certify their candidates to NASD's National Nominating Committee.

Questions/Further Information

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

National Adjudicatory Council Membership and Function

Membership

The NAC consists of 14 members—seven Industry members and seven Non-Industry members. Two Industry members are nominated by NASD's National Nominating Committee and are appointed by the NASD Regulation Board of Directors as at-large members. Five Industry members each represent one of the following geographic regions:

- Midwest Region:** Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota and Wisconsin (Districts 4 and 8)
- New York Region:** New York (the counties of Nassau and Suffolk, and the five boroughs of New York City) (District 10)
- North Region:** Connecticut, Delaware, the District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York (except for the counties of Nassau and Suffolk, and the five boroughs of New York City), Pennsylvania, Rhode Island, Vermont, Virginia and West Virginia (Districts 9 and 11)
- South Region:** Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, Texas, the Canal Zone, Puerto Rico and the Virgin Islands (Districts 5, 6 and 7)
- West Region:** Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, Washington, Wyoming and the former U.S. Trust Territories (Districts 1, 2 and 3)

Two regions (New York and West) will have open seats that need to be filled during this election. NAC members for the other three regions (Midwest, North and South) are indicated in Exhibit II, along with the year in which their terms expire.

Function

According to the NASD Regulation By-Laws, the NAC is authorized to act for the NASD Board of Governors in matters concerning:

- ▶ appeals or reviews of disciplinary proceedings, statutory disqualification proceedings or membership proceedings;
- ▶ the exercise of exemptive authority; and
- ▶ other proceedings or actions authorized by the Rules of NASD.

The NAC also considers and makes recommendations to the Board on enforcement policy and rule changes relating to the business and sales practices of NASD members and associated persons.

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EXHIBIT I

Nominees for NAC Industry Member Seats

New York Region (District 10)

Laurence H. Bertan
Sanford C. Bernstein & Co., LLC
New York, NY

West Region (Districts 1, 2 and 3)

Francis X. Roche, II
RBC Dain Rauscher Inc.
San Francisco, CA

EXHIBIT II

NAC Members with Terms Expiring in January 2007

New York Region

Judith R. MacDonald
Rothschild, Inc.
New York, NY

West Region

Neal E. Nakagiri
NPB Financial Group, LLC
Burbank, CA

NAC Members with Terms Expiring in January 2008

Midwest Region

Timothy Henahan
Baker & Co., Inc.
Rocky River, OH

South Region

W. Dennis Ferguson
Sterne Agee Clearing
Boca Raton, FL

NAC Member with Term Expiring in January 2009

North Region

Stephanie L. Brown
Linsco/Private Ledger Corp.
Boston, MA

Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Legal & Compliance
Registered Representatives
Senior Management
Trading

KEY TOPICS

NASDAQ Exchange Registration
Trading Activity Fee

GUIDANCE

Trading Activity Fee

Exemption for Registered NASDAQ Market Makers
Acting in the Capacity of Exchange Market Maker

Executive Summary

NASD is issuing this *Notice* to supersede *NASD Notice to Members (NTM) 06-37* and replace the guidance provided in that *Notice* relating to the application of the Trading Activity Fee (TAF) to members acting in the capacity of an exchange specialist or market maker. Accordingly, this *Notice* repeats pertinent information from *NTM 06-37*. However, it also provides additional guidance and clarification not included in *NTM 06-37*.

On July 5, 2006, NASDAQ announced that it would begin to operate as a national securities exchange on August 1, 2006 for NASDAQ-listed securities.¹ Section 1 of Schedule A to NASD's By-Laws exempts from the TAF proprietary transactions by a firm that is a member of both NASD and a national securities exchange, effected in its capacity as an exchange specialist or market maker, and that is subject to Securities Exchange Act of 1934, Section 11(a) and Rule 11a1-1(T)(a) thereunder. The exemption does not, however, apply to other transactions permitted by Section 11(a), such as *bona fide* arbitrage or hedge transactions.

Accordingly, on August 1, 2006 when NASDAQ became operational as an exchange in NASDAQ securities, NASD member firms that are also members of the NASDAQ Exchange became exempt from the TAF for transactions in which they act in their capacity as a registered market maker in such NASDAQ securities.² Further, when NASDAQ becomes operational as an exchange in Consolidated Quotation System (CQS) securities on approximately October 1, 2006, NASD member firms that are also members of the NASDAQ Exchange will be exempt from the TAF for transactions effected on the NASDAQ Exchange in which they act in their capacity as a registered market maker in CQS securities.

Questions/Further Information

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

Background and Discussion

In 2003, the SEC approved NASD's new member regulatory pricing structure, which: (1) eliminated the NASDAQ-based regulatory fee; (2) instituted a new transaction-based TAF applied across a broader range of equity, options and securities futures transactions; (3) increased the rates assessed to member firms under the Personnel Assessment (PA); and (4) implemented a simplified three-tiered flat rate for the Gross Income Assessment (GIA), whereby deductions and exclusions were eliminated.³ NASD uses fees collected under the member regulatory pricing structure to fund member regulatory activities, including the regulation of members through examination, processing of membership applications, financial monitoring, policymaking, rulemaking, and interpretive and enforcement activities.

As stated above, Section 1 of Schedule A to NASD's By-Laws exempts from the TAF proprietary transactions by a firm that is a member of both NASD and a national securities exchange, effected in its capacity as an exchange specialist or market maker, and that is subject to Securities Exchange Act of 1934, Section 11(a) and Rule 11a1-1(T)(a) thereunder. Accordingly, once NASDAQ is operational as an exchange, this exemption will be applicable to transactions that occur on the NASDAQ Exchange in the same manner as it is currently applicable to certain transactions that occur on other exchanges. To assist members in understanding the application of this exemption to market making activity on the NASDAQ Exchange, NASD staff is publishing the following questions and answers.

Questions and Answers

1. **Will a member be exempt for all proprietary transactions in NASDAQ-listed securities for which it is registered as a market maker?**

No. Only those proprietary transactions effected through the registered market maker's attributable quote on the NASDAQ Exchange are exempt from the TAF. Proprietary transactions of a registered market maker executed through SIZE on the NASDAQ Exchange are not exempt from the TAF, as well as transactions not effected through the NASDAQ Exchange like, for example, those reported to either a Trade Reporting Facility (TRF)⁴ or the Alternative Display Facility (ADF).⁵

2. **Does the exemption relating to registered NASDAQ Exchange market makers apply only to NASDAQ-listed securities?**

Yes. Until NASDAQ is operational as an exchange in all National Market System (NMS) securities, the TAF exemption will apply only to NASDAQ-listed securities.⁶ NASDAQ has announced that it intends to be operational as an exchange in CQS securities on October 1, 2006. Accordingly, until NASDAQ is operating as a national securities exchange in CQS securities, transactions executed through NASDAQ systems in CQS securities are still subject to the TAF. At such time that NASDAQ is operational as an exchange in CQS securities, the TAF exemption discussed above for registered market makers acting in their capacity as a registered market maker on the NASDAQ exchange will also be applicable to CQS securities.

3. **If I am a registered market maker on the NASDAQ Exchange and receive an agency order from an NASD member broker-dealer that I then send to the NASDAQ Exchange for execution, is that transaction exempt from the TAF?**

Yes. Consistent with guidance issued in *Notice to Members 02-75*, Question 3, when a member acts as agent on behalf of another NASD member in the sale of a covered security, the fee will be assessed to the member who is the ultimate seller of the security, not the member acting as agent. Therefore, an agency transaction executed on behalf of another NASD member broker-dealer on the NASDAQ Exchange by a registered market maker acting in such capacity is exempt from the TAF.

4. **If I am a registered market maker on the NASDAQ Exchange and receive an order from a customer that I send to the NASDAQ Exchange for execution, is that transaction exempt from the TAF?**

No. Transactions executed on behalf of a registered market maker's own customer, including agency and riskless principal transactions, must be assessed the TAF.

-
5. If I am a registered market maker on the NASDAQ Exchange and place an order in SIZE that is subsequently executed, is that transaction exempt from the TAF?

No. An execution resulting from an order, either agency or principal, placed into SIZE is not exempt from the TAF.

6. If I am a registered market maker and enter an attributable proprietary market making order or quote into the NASDAQ Market Center that is immediately executed (*i.e.*, does not become displayed on NASDAQ's book since it was marketable upon receipt), is the resulting execution exempt from the TAF?

Yes. Executions resulting from attributable proprietary orders or quotes entered by a registered market maker acting in the capacity of an exchange market maker are exempt from the TAF. Proprietary transactions that are not related to market making activities are not exempt from the TAF, even if executed by or through a registered market maker's MPID or account.

Endnotes

- 1 The Securities and Exchange Commission (SEC) approved NASDAQ's application for registration as a national securities exchange on January 23, 2006. See Exchange Act Release No. 53128 (Jan. 13, 2006), 71 FR 3550 (Jan. 23, 2006) (File No. 10-131). On June 30, 2006, the SEC issued an order modifying a condition to NASDAQ's operation as a national securities exchange. See Exchange Act Release No. 54085 (June 30, 2006), 71 FR 38910 (July 10, 2006) (File No. 10-131). NASDAQ plans to be operational as an exchange in NASDAQ-listed issues on August 1, 2006, and in other exchange-listed issues on or after September 1, 2006. See NASDAQ Head Trader Alert No. 2006-098 (July 5, 2006), www.nasdaqtrader.com/trader/news/2006/headtraderalerts/hta2006-098.stm and NASDAQ Head Trader Alert No. 2006-111 (July 26, 2006), www.nasdaqtrader.com/Trader/News/2006/headtraderalerts/hta2006-111.stm.
- 2 See, e.g. *Notice to Member 02-63* (Sept. 2002), Question 1.
- 3 See Exchange Act Release No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (approving SR-NASD-2002-148) and Exchange Act Release No. 47106 (Dec. 30, 2002), 68 FR 819 (Jan. 7, 2003) (approving SR-NASD-2002-99).
- 4 See Exchange Act Release No. 54084 (June 30, 2006), 71 FR 38935 (July 10, 2006) (File No. SR-NASD-2005-087) (SEC approval of the changes to NASD rules to reflect NASDAQ's registration as an exchange and the operation of the TRF by NASDAQ subject to NASD's regulatory license and oversight).
- 5 See Exchange Act Release No. 46249 (July 24, 2002), 67 FR 49822 (July 31, 2002) (SEC approval of SR-NASD-2002-97 authorizing NASD to operate the ADF on a pilot basis); Exchange Act Release No. 47633 (Apr. 10, 2003), 68 FR 19043 (Apr. 17, 2003) (File No. SR-NASD-2003-067) (extension of ADF pilot until January 26, 2004); Exchange Act Release No. 49131 (Jan. 27, 2004), 69 FR 5229 (Feb. 3, 2004) (File No. SR-NASD-2004-012) (extension of ADF pilot until October 26, 2004); Exchange Act Release No. 50601 (Oct. 28, 2004), 69 FR 64611 (Nov. 5, 2004) (File No. SR-NASD-2004-160) (extension of ADF pilot until July 26, 2005); Exchange Act Release No. 52122 (July 25, 2005), 70 FR (Aug. 1, 2005) (File No. SRNASD-2005-092) (extension of ADF pilot until April 26, 2006); Exchange Act Release No. 53699 (April 21, 2006), 71 FR 25271 (Apr. 28, 2006) (File No. SR-NASD-2006-050) (extension of ADF pilot period until January 26, 2007).
- 6 See Exchange Act Release No. 51808 (June 5, 2005), 70 FR 37496 (June 29, 2005) (File No. S7-10-04) (SEC order adopting rules under Regulation NMS and amendments to the joint industry plans for disseminating market information).

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Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Advertising
Executive Representatives
Legal & Compliance
Registered Representatives
Senior Management

KEY TOPICS

Correspondence
Rule 2211

GUIDANCE

Correspondence

SEC Approves Amendments to NASD Rule 2211 to Require Principal Pre-Use Approval of Certain Member Correspondence Sent to 25 or More Existing Retail Customers within a 30 Calendar-Day Period;
Effective Date: December 1, 2006

Executive Summary

On July 26, 2006, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 2211, which governs NASD member institutional sales material and correspondence.¹ The amendments require a registered principal to approve correspondence sent to 25 or more existing retail customers within any 30 calendar-day period if the correspondence makes any financial or investment recommendation or otherwise promotes a product or service of the member.

The effective date of this rule change is December 1, 2006. Included with this *Notice* is Attachment A (text of rule amendments).

Questions/Further Information

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

Background and Discussion

In 2003, the SEC approved as part of NASD's modernization of its advertising rules the creation of new Rule 2211, which included an amended definition of "correspondence." That definition of correspondence included any written letter or electronic mail message distributed by a firm to one or more of its existing retail customers and to fewer than 25 prospective retail customers within a 30 calendar-day period.² Previously, "correspondence" included any written or electronic communication prepared for delivery to a single current or prospective customer, and not for dissemination to multiple customers or the general public.

The definition of correspondence is significant in several respects. Firms generally are not required to have a registered principal approve correspondence prior to use, nor are they required to file correspondence with the NASD Advertising Regulation Department (Department). In addition, correspondence is subject to fewer content restrictions than advertisements and sales literature.

NASD found that some member correspondence to multiple existing customers raised the same regulatory concerns as member advertisements and sales literature, yet it was not required to be filed with NASD or approved by a principal prior to use. In contrast, had those types of form letters been sent to at least 25 *prospective* retail customers, such correspondence would have required both registered principal pre-use approval and filing with the Department. As a result, NASD believes it no longer should apply the principal pre-use approval requirement differently to non-clerical correspondence sent to prospective and existing retail customers.

The amendments to Rule 2211 approved by the SEC require registered principal pre-use approval of any correspondence sent to 25 or more existing retail customers within any 30 calendar-day period if the correspondence makes any financial or investment recommendation or otherwise promotes a product or service of the member. Registered principal pre-use approval will better ensure that this material complies with applicable standards of the advertising rules before reaching current or prospective customers. This correspondence need not be filed with the Department and is not subject to all of the content standards of the advertising rules. Of course, a firm may choose to file this correspondence with the Department to better ensure that it complies with applicable standards, particularly when the correspondence promotes the firm's products or services.

The registration required of a principal that approves correspondence prior to use pursuant to amended Rule 2211(b) is the same as the registration required for a principal that supervises correspondence under Rule 3010(d)(2). Accordingly, a member may opt to utilize a General Securities Sales Principal (formerly Series 8 and now Series 9/10) to perform this function.

This rule change becomes effective on December 1, 2006.

Endnotes

- 1 See SEC Rel. No. 34-54217 (July 26, 2006), 71 Fed. Reg. 43831 (Aug. 2, 2006) (File No. SR-NASD-2006-11).
- 2 NASD has clarified that, for purposes of its rules governing member communications with the public, NASD views instant messaging in the same manner in which it views traditional electronic mail messages. Accordingly, instant messaging may qualify as correspondence or sales literature, depending upon the facts and circumstances. See *Notice to Members 03-33* (July 2003).
- 3 NASD Rule 3010(d)(2) requires each member to develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing correspondence with the public relating to its investment banking or securities business. Where such procedures do not require review of all correspondence prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing correspondence, documentation of such education and training, and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

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ATTACHMENT A

Text of Rule Change

New text is underlined; deletions are in brackets.

* * * *

2211. Institutional Sales Material and Correspondence

(a) No change.

(b) Approval and Recordkeeping

(1) Registered Principal Approval

(A) Correspondence. Correspondence need not be approved by a registered principal prior to use, [but] unless such correspondence is distributed to 25 or more existing retail customers within any 30 calendar-day period and makes any financial or investment recommendation or otherwise promotes a product or service of the member. All correspondence is subject to the supervision and review requirements of Rule 3010(d).

(B) No change.

(2) No change.

(c) through (e) No change.

Notice to Members

AUGUST 2006

SUGGESTED ROUTING

Institutional
Legal & Compliance
Options
Senior management
Trading
Training

KEY TOPICS

Exercise Limits
Options
Position Limits
Rule 2860

GUIDANCE

Options Position and Exercise Limits

Extension of Pilot Program Increasing Position and Exercise Limits for Stock Options

Executive Summary

On August 10, 2006, NASD filed for immediate effectiveness with the Securities and Exchange Commission (SEC) amendments to Rule 2860 extending until March 1, 2007, a pilot program increasing certain stock options position and exercise limits. The pilot program was scheduled to expire on September 1, 2006.

The rules, as amended, are set forth in Attachment A.

The amendments become effective September 1, 2006.

Questions/Further Information

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), Regulatory Policy and Oversight (RPO), at (202) 728-8104; or James L. Eastman, Assistant General Counsel, OGC, RPO at (202) 728-6961.

Background and Discussion

On August 10, 2006, NASD filed for immediate effectiveness with the SEC amendments to Rule 2860 extending until March 1, 2007, a pilot program increasing certain stock options position and exercise limits (Pilot Program).¹ The Pilot Program was scheduled to expire on September 1, 2006.² NASD extended the Pilot Program to allow it to continue without interruption.

NASD Rule 2860(b)(3)(A) imposes a ceiling or position limit on the number of conventional and standardized equity options contracts in each class on the same side of the market (*i.e.*, aggregating long calls and short puts or long puts and short calls) that can be held or written by a member, a person associated with a member, a customer or a group of customers acting in concert.³ The rule provides that the position limits for stock options are determined according to a five-tiered system in which more actively traded stocks with larger public floats are subject to higher position limits.

Pursuant to the Pilot Program, which began March 30, 2005, and now ends March 1, 2007 (unless extended) (Pilot Period), the limits for each of the tiers remains increased as follows: a) 13,500 contracts has been increased to 25,000 contracts; b) 22,500 contracts has been increased to 50,000 contracts; c) 31,500 contracts has been increased to 75,000 contracts; d) 60,000 contracts has been increased to 200,000 contracts; and e) 75,000 contracts has been increased to 250,000 contracts. These tiers apply to both conventional and standardized options. Options exercise limits, which are set forth in Rule 2860(b)(4), and which incorporate by reference the position limits in Rule 2860(b)(3), also have been increased during the Pilot Period.

Endnotes

- 1 Securities Exchange Act Release No. 34-54334 (August 18, 2006), 71 FR 50961 (August 28, 2006) (SR-NASD-2006-097).
- 2 See Securities Exchange Act Release No. 53346 (February 22, 2006), 71 FR 10580 (March 1, 2006) (SR-NASD-2006-025) (extending Pilot Program); *NASD Notice to Members 06-09* (March 2006); Securities Exchange Act Release No. 52271 (August 16, 2005), 70 FR 49344 (August 23, 2005) (SR-NASD-2005-097) (extending Pilot Program); *NASD Notice to Members 05-56* (August 2005); Securities Exchange Act Release No. 51520 (April 11, 2005), 70 FR 19977 (April 15, 2005) (SR-NASD-2005-040) (establishing Pilot Program); *NASD Notice to Members 05-31* (April 2005).
- 3 A “standardized equity option” is an equity options contract issued, or subject to issuance by, The Options Clearing Corporation that is not a FLEX Equity Option. NASD Rule 2860(b)(2)(UU). A “conventional option” is an option contract not issued, or subject to issuance by, The Options Clearing Corporation. NASD Rule 2860(b)(2)(N). NASD’s limits on standardized equity options are applicable only to those members that are not also members of the exchange on which the option is traded; the limits on conventional options are applicable to all NASD members. NASD Rule 2860(b)(1)(A).

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ATTACHMENT A

New text is underlined; deletions are in brackets.

2800. SPECIAL PRODUCTS

2860. Options

(a) No Change.

(b) Requirements.

(1) and (2) No Change.

(3) Position Limits

(A) Stock Options—Except in highly unusual circumstances, and with the prior written approval of NASD pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, non-member broker, or non-member dealer, an opening transaction through Nasdaq, the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate equity options position in excess of:

(i) 13,500 (or 25,000 during the pilot period from March 30, 2005 through [September 1, 2006]March 1, 2007 (“Pilot Period”)) option contracts of the put class and the call class on the same side of the market covering the same underlying security, combining for purposes of this position limit long positions in put options with short positions in call options, and short positions in put options with long positions in call options; or

(ii) through (viii) No Change.

(B) through (D) No Change.

(4) through (24) No Change.

Disciplinary and Other NASD Actions

REPORTED FOR AUGUST

NASD® has taken disciplinary actions against the following firms and individuals for violations of NASD rules; federal securities laws, rules and regulations; and the rules of the Municipal Securities Rulemaking Board (MSRB). The information relating to matters contained in this *Notice* is current as of the end of July 2006.

Firm Expelled, Individuals Sanctioned

Greater Metropolitan Investment Services, Inc. (CRD #17452, Bedminster, New Jersey), Chintaman M. Dalvi (CRD #1981088, Registered Principal, Mendham, New Jersey) and James Thomas Patten (CRD #1143818, Registered Principal, Bernardsville, New Jersey) submitted Offers of Settlement in which the firm was expelled from NASD membership and Dalvi and Patten were barred from association with any NASD member in any capacity. Without admitting or denying the allegations, the respondents consented to the described sanctions and to the entry of findings that the firm and Patten, directly or indirectly, by use of means or instrumentalities of interstate commerce, intentionally or recklessly employed a device, scheme or artifice to defraud, or engaged in an act, practice or course of business that operated or would operate as a fraud or deceit in connection with the purchase or sale of a security, in that they manipulated the price of a stock. The findings stated that the firm and Patten falsely marked many customer order tickets as unsolicited orders when, in fact, they had solicited customers to buy or sell the stock. The findings also stated that the respondents countenanced a supervisory system that did not apply or monitor procedures with regard to Patten's trading activities, and thereby failed to establish, maintain or enforce a system to supervise the activities of each of the firm's registered representatives and associated persons reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules. The findings also included that the firm's written supervisory procedures contained inadequate or non-existent procedures relating to compliance with anti-fraud, anti-manipulation and recordkeeping provisions of securities laws, regulations and NASD rules. NASD also found that Dalvi failed to establish, maintain and enforce written procedures designed to achieve compliance with anti-fraud and recordkeeping provisions of securities laws, regulations and NASD rules. In addition, NASD determined that the firm and Dalvi failed to reasonably supervise Patten's trading activities in a security and his improper marking of customer order tickets in the security as unsolicited. (NASD Case #2005000245601)

Firms Fined, Individuals Sanctioned

Beerbaum & Beerbaum, Financial and Insurance Services, Inc. (CRD #17099, Santa Rosa, California) and Hans Norman Beerbaum (CRD #717043, Registered Principal, Petaluma, California). The firm was fined \$15,000 and Beerbaum was barred from association with any NASD member in any capacity. The National Adjudicatory Council (NAC) imposed the sanctions following an appeal of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that the firm permitted Beerbaum to conduct securities business, provide supervision and prepare and file annual audit reports without having been properly registered with NASD to engage in such activities.

This action has been appealed to the Securities and Exchange Commission (SEC). All sanctions are not in effect pending consideration of the appeal. **(NASD Case #C01040019/C0120040019)**

PGP Financial, Inc. (CRD #21617, Hauppauge, New York) and Ellen Rose Lozinski (CRD #2372418, Registered Principal, Great River, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$25,000, jointly and severally with Lozinski. Lozinski was suspended from association with any NASD member in a principal capacity for ten business days. Without admitting or denying the findings, the firm and Lozinski consented to the described sanctions and to the entry of findings that the firm, acting through Lozinski, operated a securities business without a properly registered financial and operations principal (FINOP). The findings stated that the firm, acting through Lozinski, failed to timely file the Uniform Termination Notice for Securities Industry Registration (Form U5) concerning a registered person within 30 days from the date of termination. The findings also stated that the firm, acting through Lozinski, conducted a securities business while failing to maintain its minimum net capital requirement.

The suspension in a principal capacity was in effect from July 17, 2006 through July 28, 2006. **(NASD Case #ELI2005000631601)**

The Shemano Group, Inc. (CRD #35528, San Francisco, California), William David Corbett (CRD #1478411, Registered Representative, Belvedere, California), Michael Keith McDonough (CRD

#1511844, Registered Principal, Alameda, California) and Gary Jay Shemano (CRD #421322, Registered Principal, Kentfield, California) submitted Letters of Acceptance, Waiver and Consent in which the firm and Shemano were fined \$425,000, jointly and severally. The firm and Shemano were barred from publishing research reports as the term is defined in NASD Rule 2711(a), and the firm was required to hire an independent consultant to review the adequacy of the firm's policies, systems, procedures and training. Shemano was suspended from association with any NASD member in any capacity for 90 days. Corbett was fined \$150,000 and suspended from association with any NASD member in any capacity for 60 days. McDonough was fined \$20,000 and suspended from association with any NASD member as a general securities principal for nine months. Without admitting or denying the findings, the respondents consented to the described sanctions and to the entry of findings that Shemano sold Corbett's shares of a publicly traded company while Corbett was reviewing drafts of a pending research report on the company that contained mismanagement allegations, and Corbett, as lead banker, and McDonough, as Chief Compliance Officer, failed to detect and prevent the sales. The findings stated that the firm, Shemano and McDonough failed to establish, maintain and enforce a system of supervision and written supervisory procedures reasonably designed to prevent the misuse of material and nonpublic information, and to achieve compliance with applicable securities laws, regulations and NASD rules. The findings stated that Corbett provided knowing and substantial assistance to his firm in violation of its written supervisory procedures. The findings also stated that Corbett knowingly hired, and the firm made payments to, an individual for consulting services relating to the issuance of research reports and investment banking activities who they knew to be statutorily disqualified from association with any NASD member, and failed to report the association to NASD. The findings also included that the firm published research reports the barred individual wrote that deleted material risk disclosures and failed to disclose material facts, and McDonough failed to supervise the preparation of the research reports. NASD found that the firm failed to reasonably supervise the firm's research and investment banking departments and the barred consultant in connection with their activities relating to the issuance of research reports.

Corbett's suspension in any capacity will be in effect from July 11, 2006 through September 8, 2006. McDonough's suspension in a principal capacity will be in effect from October 16, 2006 through July 15, 2007. Shemano's suspension in any capacity will be in effect from June 19, 2006 through September 16, 2006. (NASD Cases 20050001727-01/20050001727-02/20050001727-03)

Firms and Individuals Fined

Conners & Co., Inc. (CRD #1511, Cincinnati, Ohio) and Robert Louis Conners (CRD #52353, Registered Principal, Cincinnati, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which they were censured and fined \$10,000, jointly and severally. The firm was fined an additional \$5,000. Without admitting or denying the findings, the firm and Conners consented to the described sanctions and to the entry of findings that the firm, acting through Conners, executed customer transactions in municipal securities that were inaccurately or not timely reported, in that transactions were not reported to the MSRB within 15 minutes of the execution times, and reported trades that should not have been reported. The findings stated that the firm failed to prepare and maintain accurate order memoranda for municipal securities transactions. The findings also stated that the firm, acting through Conners, failed to establish, maintain and enforce adequate written supervisory procedures reasonably designed to achieve compliance with applicable MSRB rules related to the reporting of municipal securities transactions. The findings also included that the firm, acting as underwriter in primary offerings of municipal securities, failed to timely file Forms G-36(OS) with the MSRB. (NASD Case #E8A2005005401)

Hunter Scott Financial LLC (CRD #45559, Delray Beach, Florida) and Peter Alex Gouzous (CRD# 1959666, Registered Principal, Delray Beach, Florida) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Gouzous was censured and fined \$10,000, jointly and severally with the firm, and required to register for 16 hours of training concerning anti-money laundering (AML), in a program not unacceptable to NASD. Without admitting or denying the findings, the firm and Gouzous consented to the described sanctions

and to the entry of findings that the firm, acting through Gouzous, failed to adequately implement its AML compliance program. (NASD Case #2005002185901)

Southwest Securities, Inc. (CRD #6220, Dallas, Texas), Stuart Martin Berwick (CRD #1031019, Registered Principal, Dallas, Texas) and Louis Joseph Matrone (CRD #2206335, Registered Principal, Frisco, Texas) submitted a Letter of Acceptance, Waiver and Consent in which they were censured. The firm was fined \$40,000, \$20,000 of which was jointly and severally with Berwick, and \$10,000 of which was jointly and severally with Matrone. The firm was also fined an additional \$120,000 and required to revise its written supervisory procedures regarding registration requirements, SEC Rules 11Ac1-1, 11Ac1-5, riskless principal trade reporting, the Order Audit Trail SystemSM (OATSSM) and the Trade Reporting and Compliance Engine (TRACE) trade reporting. Without admitting or denying the findings, the respondents consented to the described sanctions and to the entry of findings that the firm failed to properly register Berwick and Matrone as general securities principals, and Berwick and Matrone failed to ensure that they were properly registered. The findings stated that the firm's supervisory system and written supervisory procedures failed to provide for supervision reasonably designed to achieve compliance with respect to compliance with applicable securities laws, regulations and NASD rules concerning registration requirements, SEC Rules 11Ac1-1, 11Ac1-5, riskless principal trade reporting, OATS and TRACE trade reporting. The findings also included that the firm submitted quarterly order routing information reports that incorrectly disclosed an "Unspecified Route Venue" to which the firm's orders were routed, and the firm failed to submit any route reports to OATS related to Cancel/Replace reports that the firm was required to submit. NASD found that the firm, as an Intermarket Trading System/Computer Assisted Execution System (ITS/CAES) Market Maker, purchased or sold ITS/CAES securities, whether in a principal capacity or as an agent, at prices that were lower than the bid or higher than the offer displayed from an ITS Participant Exchange or ITS/CAES Market Maker. NASD also found that the firm failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE that it was required to report within 45 minutes of execution. (NASD Case #20042000225-01)

Thor Capital, LLC (CRD #45716, New York, New York) and Peter A. Kambolin (CRD #2637562, Registered Principal, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which they were censured and fined \$10,000, jointly and severally, and the firm was fined an additional \$5,000. Without admitting or denying the findings, the firm and Kambolin consented to the described sanctions and to the entry of findings that the firm, acting through Kambolin, published a Web site that contained inaccurate statements regarding the trading volume the firm handled on behalf of customers, the type of securities in which it conducted an active business and the number of states in which it was currently registered. The findings stated that the firm's new account documentation for public customer accounts failed to include employment information, income information, net worth and investment objectives. (NASD Case #E1020030516-01)

Firms Fined

Andrew Garrett, Inc. (CRD #29931, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which it was censured and fined \$17,500, of which \$7,500 was imposed jointly and severally with an individual. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it conducted a securities business when its net capital fell below the minimum amount required under SEC Rule 15c3-1. The findings stated that the firm, acting through an individual, prepared inaccurate net capital computations. (NASD Case #E1020050019-01)

Banorte Securities International, Ltd., (CRD #30648, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which it was censured and fined \$17,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to enforce its written supervisory procedures to ensure that it conducted its business in accordance with MSRB rules. The findings stated that the firm did not have a properly registered municipal securities principal, failed to properly complete order tickets for municipal securities, and its municipal securities transactions were reported to the MSRB late. The findings also stated that the firm failed to seek approval for a change to its

membership agreement prior to engaging in business as a municipal broker or dealer. (NASD Case #E1020050483-02)

Bear Stearns & Co. Inc. (CRD #79, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which it was censured and fined \$150,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to submit options communications for review by a Compliance Registered Options Principal or an appropriate designee, and the firm's educational material was not submitted to NASD or another self-regulator for review and approval at least 10 days prior to the firm's use, as NASD Rule 2220 requires. The findings stated that the firm's options communications omitted material facts that made them false and/or misleading, suggested a certainty of future performance, used hedge clauses or disclaimers that attempted to disclaim responsibility for the communications, and included discussion of the advantages and opportunities presented by option investments without the proper disclosure of risks. The findings also stated that the communications failed to include the required warning that options are not suitable for all investors, potential risks associated with options, the name and address of a person who could provide an Options Disclosure Document, relevant costs and a statement that supporting documentation for any claims made in the communication would be supplied upon request. The findings also included that the firm's research report failed to define the meaning of the ratings used in the report, failed to disclose the distribution of ratings used in the firm's rating system and failed to provide required disclosures or references to where the disclosures could be found on the front page of the research report. NASD found that the firm failed to establish, maintain and enforce a supervisory system and procedures reasonably designed to achieve compliance with certain federal securities laws and NASD rules regarding content standards and principal approval of options communications with the public. (NASD Case #E1020040050-01)

Chapelaine Corporate Securities & Co. (CRD #23741, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$13,500 and required to revise its written supervisory procedures with respect to OATS compliance. Without admitting or denying the findings,

the firm consented to the described sanctions and to the entry of findings that it failed to accept or decline transactions in eligible securities through the NASDAQ Market Center within 20 minutes after execution, when the firm had an obligation to report them as the order entry identifier (OEID). The findings stated that the firm failed to timely report Reportable Order Events (ROEs). The findings also stated that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning OATS compliance. **(NASD Case #20042000279-01)**

Conifer Securities, L.L.C. (CRD #23857, San Francisco, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$10,000 and required to revise its written supervisory procedures with respect to OATS. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to timely report ROEs to OATS. The findings stated that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws, regulations and NASD rules concerning OATS. **(NASD Case #20050000063-01)**

ING Investment Management Services LLC (CRD #21644, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$50,000 and required to review its procedures regarding the preservation of electronic mail communications for compliance with NASD rules and federal securities laws and regulations. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to maintain and preserve all electronic communications relating to its business as SEC Rule 17a-4 requires. In determining the amount of the fine, NASD took into account the demonstrable corrective action undertaken by the firm before the staff commenced its examination. **(NASD Case #E102004019901)**

Lexington Investment Company, Inc. (CRD #27393, Lexington, Kentucky) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it

failed to maintain the minimum required net capital, prepared inaccurate trial balances and net capital computations, and filed inaccurate FOCUS Part IIA reports. The findings stated that the firm entered into a membership agreement with NASD that it would not hold customer funds or safe keep customer securities, but the firm deducted funds from employee salaries for deposit in the firm's 401(k) fund and held the funds until they were deposited at a later date. The findings also stated that the MSRB prepared a Customer Transaction Compliance Report that showed that the percentage of the firm's municipal trades reported late was substantially larger than the industry average. The findings also included that the firm executed municipal securities transactions that were not timely reported. NASD found that the firm failed to establish, maintain and enforce adequate written supervisory procedures that were reasonably designed to achieve compliance with applicable MSRB rules related to municipal securities transaction reporting. **(NASD Case #E8A2005013001)**

Oppenheimer & Co., Inc. (CRD #249, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which it was censured, fined \$17,500 and required to revise its written supervisory procedures with respect to maintaining two-sided quotations as an ITS/CAES Market Maker. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that, as an ITS/CAES Market Maker, it failed to maintain continuous two-sided quotations in the absence of the grant of an excused withdrawal or a functional excused withdrawal by NASD. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws, regulations and NASD rules concerning maintaining two-sided quotations as an ITS/CAES Market Maker. **(NASD Case #20050002356-01)**

Penson Financial Services, Inc. (CRD #25866, Dallas, Texas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, 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 the customer's behalf, or that the firm could borrow

the security on the customer's behalf for delivery by the settlement date. The findings stated that the firm submitted reports with respect to equity securities traded on the NASDAQ Stock Market to OATS that were not in the electronic form prescribed by NASD and were repairable. **(NASD Case #20041000171-01)**

Piper Jaffray & Co. (CRD #665, Minneapolis, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$26,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit last sale reports of transactions in eligible securities through the Automated Confirmation Transaction ServiceSM (ACTSM), and failed to designate some of them as late. The findings stated that the firm failed to report the correct symbol indicating whether a transaction was a "buy," "sell," "sell short," "sell short exempt" or "cross" for transactions in eligible securities to ACT. The findings also stated that the firm transmitted reports that contained inaccurate, incomplete or improperly formatted data to OATS, in that the reports contained an incorrect time associated with the transaction. The findings also included that the firm failed to provide written notification disclosing to its customers that transactions were executed at an average price. NASD found that the firm, in transactions for or with a customer, failed to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant price was as favorable as possible under prevailing market conditions. **(NASD Case #20050001007-01)**

Schonfeld Securities, L.L.C. (CRD #23304, Jericho, New York) submitted a Letter of Acceptance, Waiver and Consent in which it was censured, fined \$12,500 and required to revise its supervisory procedures with respect to OATS compliance. Without admitting or denying the findings, its consented to the described sanctions and to the entry of findings that it failed to timely report ROEs to OATS. The findings 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 OATS compliance. **(NASD Case #20050000107-01)**

Scottrade, Inc. (CRD #8206, St. Louis, Missouri) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$30,000.

Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to submit Route Reports related to Cancel/Replace Reports to OATS. The findings stated that the firm submitted reports with respect to equity securities traded on the NASDAQ Stock Market to OATS that were not in the NASD-prescribed electronic form. OATS rejected the reports, and notice of the rejection was made available to the firm on the OATS Web site, but the firm failed to correct some of the reports. The findings also stated that the firm failed to maintain written documents evidencing the reporting agent agreement(s) it had in effect. The findings also included that the firm failed to enforce its written supervisory procedures that specified that it would maintain reports of each day's rejections with notations explaining what was repaired and resubmitted. **(NASD Case #20050000057-01)**

Screaming Eagle Trading, Inc. (CRD #126125, Orinda, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to submit required information to OATS. The findings 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 OATS. **(NASD Case #20050007066-01)**

Strasbourg, Pearson, Tulcin, Wolff, Inc. (CRD #5133, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to execute a TRACE Participation Agreement and therefore was not eligible to participate in TRACE. The findings stated that the firm failed to report all of the TRACE transactions in TRACE-eligible securities it was required to report. 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 TRACE. **(NASD Case #20050011479-01)**

Terra Nova Trading, L.L.C. (CRD #37761, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$25,000. Without admitting or denying the findings,

the firm consented to the described sanctions and to the entry of findings that it failed to comply with SEC Rule 15c3-3, in that it failed to deposit in the Special Reserve Bank Account for the Exclusive Benefit of Customers (Reserve Bank Account) amounts required to satisfy its reserve requirement as computed according to the Reserve Formula Computation. The findings stated that the firm failed to adequately supervise its preparation and computation of the Reserve Bank Account requirements that resulted in insufficient funding. (NASD Case #E8A2005003501)

Turning Point Securities, LLC (CRD #104457, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which it was censured, fined \$10,000 and required to revise its written supervisory procedures regarding trade reporting. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit last sale reports of transactions in eligible securities that it was required to report through NASDAQ. The findings stated that the firm incorrectly designated last sale reports of transactions in eligible securities reported to NASDAQ Market Center within 90 seconds of execution as “.SLD”. The findings also stated that the firm’s supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws, regulations and NASD rules concerning trade reporting. (NASD Case #20050004987-01)

Westport Capital Markets, LLC (CRD #41562, Westport, Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which it was censured and fined \$22,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to execute a TRACE participant application agreement, and therefore, was not a TRACE participant. The findings stated that the firm failed to report TRACE-eligible transactions. The findings also stated that the firm accepted customer checks payable to the firm, rather than ensuring that their customers made their checks payable to its clearing firm. Therefore, it was in violation of Section 15(c) of the Exchange Act and SEC Rule 15c3-3 thereunder. The findings also included that the firm used the instrumentalities of interstate commerce to conduct a securities business while failing to maintain the minimum required net capital. NASD

found that the firm failed to have written supervisory procedures reasonably described to comply with TRACE reporting requirements and the Customer Protection Rule. (NASD Case #E112005003901)

Individuals Barred or Suspended

Eugene Gilbert Abeyta, Jr. (CRD #2987570, Registered Representative, Los Lunas, New Mexico) was barred from association with any NASD member in any capacity. The sanction was based on findings that Abeyta engaged in outside business activities and failed to provide prompt written notice to his member firm. The findings stated that Abeyta failed to respond to NASD requests for documents and information. (NASD Case #E3A2004036101)

Dean Russel Baker (CRD #4493790, Registered Representative, Coral Springs, Florida) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Baker consented to the described sanction and to the entry of findings that he effected, or caused to be effected, securities transactions in public customers’ accounts without their prior authorization, knowledge or consent. The findings stated that in order to induce customers to make authorized purchases, Baker made baseless price predictions, used time sensitivity when recommending stocks and failed to disclose material facts such as risks and conflicts of interest associated with the stock purchases. (NASD Case # E072004052202)

Steven John Balog (CRD #857771, Registered Principal, Woodbine, 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 findings, Balog consented to the described sanction and to the entry of findings that he engaged in outside business activities, for compensation, without providing prompt written notice to his member firm. (NASD Case #E9A2004049802)

Alan Edmund Bartholemy, Jr. (CRD #3122838, Registered Representative, Folsom, 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 findings, Bartholemy consented to the described

sanction and to the entry of findings that he willfully failed to amend his Uniform Application for Securities Industry Registration or Transfer (Form U4) to disclose material information. **(NASD Case #20050034152-01)**

Joseph Michael Blackwell (CRD #22729, Registered Principal, Vancouver, Washington) submitted a Letter of Acceptance, Waiver and Consent in which he was suspended from association with any NASD member in any principal or supervisory capacity, or as an AML officer, for one year, and required to attend and satisfactorily complete 16 hours of continuing education concerning AML before he reassociates with any NASD member firm in any principal or supervisory capacity or as an AML compliance officer. In light of Blackwell's financial status, no monetary sanction has been imposed. Without admitting or denying the findings, Blackwell consented to the described sanctions and to the entry of findings that he failed to establish and implement an AML compliance program reasonably designed to achieve compliance with the Bank Secrecy Act.

The suspension in any principal or supervisory capacity, or as an AML compliance officer, is in effect from July 17, 2006 through July 16, 2007. **(NASD Case #20050011006)**

Christopher Charles Bourlier (CRD #2756033, Registered Principal, Montgomery, Texas) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the findings, Bourlier consented to the described sanctions and to the entry of findings that he recommended securities transactions to a public customer without having reasonable basis for believing the recommendations were suitable for the customer.

The suspension in any capacity was in effect from July 17, 2006 through July 28, 2006. **(NASD Case #20050004254-01)**

Eric James Brown (CRD #2203972, Registered Representative, Highland Beach, Florida) submitted an Offer of Settlement in which he was fined \$15,000, ordered to pay \$17,653.52 plus interest in restitution to a public customer and suspended from association with any NASD member in any capacity for three months.

The fine and restitution must be paid before Brown reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the allegations, Brown consented to the described sanctions and to the entry of findings that he recommended the purchase and sale of multiple variable annuities and variable life products to public customers that were unsuitable in view of their financial situations, investment objectives, circumstances and needs. The findings stated that Brown completed applications for a public customer to purchase variable annuities and made false statements on them, thus creating a false book and record at his member firm.

The suspension in any capacity is in effect from July 17, 2006 through October 16, 2006. **(NASD Case #E112003006903)**

Dominick Anthony Burke (CRD #2578387, Registered Principal, Nanuet, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Burke reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Burke consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Form U4.

The suspension in any capacity is in effect from July 17, 2006 through October 16, 2006. **(NASD Case #2006004760001)**

Kelly Ann Burke (CRD #4895800, Associated Person, Tinley Park, Illinois) submitted an Offer of Settlement in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Burke consented to the described sanction and to the entry of findings that she completed and submitted electronic applications for automobile insurance to an insurance company with false information, including Social Security numbers, to qualify the applicants for insurance at better rates. The findings stated that Burke failed to respond to NASD requests for documents and information. **(NASD Case #2005001331101)**

Larry Steven Capstick (CRD #2776904, Registered Representative, Germantown, Tennessee) 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 business days. The fine must be paid before Capstick reassociates with a member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Capstick consented to the described sanctions and to the entry of findings that he engaged in an outside business activity for compensation without providing his member firm with written notice.

The suspension in any capacity is in effect from July 17, 2006 through August 25, 2006. (NASD Case #2005001908901)

Steven Charles Clyde (CRD #1512386, Registered Principal, Fair Oaks, California) was barred from association with any NASD member in any capacity. The sanction was based on findings that Clyde made unauthorized withdrawals totaling \$43,000 from public customers' accounts by forging their signatures on documents and providing them with other documents to assuage their concerns about the withdrawals from their accounts. The findings stated that Clyde failed to respond to NASD requests to provide on-the-record testimony. (NASD Case #E062004019501)

John D. Chehovich (CRD #4804581, Registered Representative, Junedale, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Chehovich consented to the described sanction and to the entry of findings that he made unauthorized withdrawals totaling \$63,000 from public customers' accounts by forging their names on bank withdrawal slips, deposited the funds into a fictitious bank account he controlled and converted the funds to his own use without the customers' consent. (NASD Case #2006004149101)

Jack Thomas Cole (CRD #3006129, Registered Representative, Isanti, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Cole consented to the described sanction and to

the entry of findings that he failed to respond to NASD requests for information. (NASD Case #2005002853101)

Herbert Hunt Covington, III (CRD #2080038, Registered Representative, Chagrin Falls, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Covington consented to the described sanction and to the entry of findings that he engaged in outside business activities and failed to provide prompt written notice to his member firm. The findings stated that Covington engaged in private securities transactions, for compensation, and failed to give prompt written notice to, or receive written approval from, his member firm. The findings also stated that Covington failed to respond to NASD requests for documents and to appear for an on-the-record interview. (NASD Case #E8A2004080201)

Joseph Anthony D'Altilia (CRD #850779, Registered Representative, Colorado Springs, Colorado) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, D'Altilia consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for documents and information. (NASD Case #2005002047601)

Brian Emil Davis (CRD #2334949, Registered Representative, Chicago, Illinois) 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 findings, Davis consented to the described sanction and to the entry of findings that he received \$2,892.79 from a public customer to pay for an extension of a universal life insurance contract, but instead deposited the funds into his personal bank account and converted them to his personal use. (NASD Case #20050028100-01)

John Joseph Delaney (CRD #64352, Registered Representative, Jupiter, Florida) submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 20 business days. Without admitting or denying the allegations, Delaney consented to the

described sanctions and to the entry of findings that he exercised discretionary power in public customers' accounts without obtaining prior written authorization from the customers and prior written acceptance of the accounts as discretionary from his member firm.

The suspension in any capacity was in effect from July 17, 2006 through August 11, 2006. **(NASD Case #EAF0300770001)**

Philip Orezio Fatta (CRD #1467533, Registered Principal, Holtsville, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$14,000, which includes \$4,000 in disgorgement of commissions received, and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the findings, Fatta consented to the described sanctions and to the entry of findings that he improperly altered account transfer forms that had been signed and used by public customers from his previous firm as though they were new account transfer forms for purposes of transferring the customers' accounts to his firm, thus causing his firm's books and records to be inaccurate. The findings stated that Fatta charged customers unreasonable and excessive option commissions on covered call transactions.

The suspension in any capacity is in effect from August 7, 2006 through November 6, 2006. **(NASD Case #E1020040299-05)**

Jorge Guillermo Fernandez (CRD #1220231, Registered Principal, Mayfield Heights, Ohio) was barred from association with any NASD member in any capacity. The sanction was based on findings that Fernandez induced public customers to participate in a new investment and to make their checks made payable to the firm, which he deposited into an unauthorized corporate bank account he had opened in the firm's name by falsely identifying himself as the president of the firm. The findings stated that Fernandez wire transferred \$1,500,000 from the unauthorized bank account to a bank overseas for his personal use. The findings also stated that Fernandez failed to respond to NASD requests for information. **(NASD Case #2005000545601)**

Matthew Bene Forman (CRD #4689759, Registered Principal, Portland, Oregon) submitted a Letter of

Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Forman reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Forman consented to the described sanctions and to the entry of findings that he knowingly prepared and submitted false life insurance applications and a false agent's report in connection with the purchase of variable universal life insurance policies, causing his member firm to maintain inaccurate books and records regarding the false applications.

The suspension in any capacity will be in effect from July 3, 2006 through July 2, 2007. **(NASD Case #2005002683901)**

Matthew Jay Forry (CRD #3199935, Registered Principal, York, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 business days. The fine must be paid before Forry reassociates with any NASD member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Forry consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, without providing his member firm with prompt written notice.

The suspension in any capacity is in effect from July 17, 2006 through August 25, 2006. **(NASD Case #2005003237501)**

Stephen William Godfrey (CRD #4319775, Registered Representative, Waukesha, Wisconsin) was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine is due and payable when and if Godfrey seeks to return to the securities industry. The sanctions were based on findings that Godfrey failed to amend his Form U4 to disclose material information.

The suspension in any capacity is in effect from July 17, 2006 through August 16, 2006. **(NASD Case #E8A2004096901)**

Melanie Erin Howell (CRD #5074630, Associated Person, Olney, 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 findings, Howell consented to the described sanction and to the entry of findings that, during a Series 7 qualification examination, she retained in her possession notes related to the subject matter of the qualification examination. Therefore, she violated the Rules of Conduct she had signified acceptance of prior to the examination. **(NASD Case #2006004235701)**

Eric Carlin Howie (CRD #4328428, Registered Representative, Milpitas, California) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$6,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Howie reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Howie consented to the described sanctions and to the entry of findings that he participated in private securities transactions, for compensation, without prior approval from his member firm.

The suspension in any capacity is in effect from August 7, 2006 through September 5, 2006. **(NASD Case #2005002880701)**

Edwin Henry Jaffe (CRD #1382154, Registered Principal, Memphis, Tennessee) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for nine months. Without admitting or denying the findings, Jaffe consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing his member firm with prior written notice of the proposed transactions and his role therein.

The suspension in any capacity will be in effect from August 21, 2006 through May 20, 2007. **(NASD Case #E052004022602)**

Carl Phillip Kellogg (CRD #865366, Registered Representative, Ada, Michigan) 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 60 days. The fine

must be paid before Kellogg reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Kellogg consented to the described sanctions and to the entry of findings that he borrowed approximately \$140,000 from public customers in violation of his member firm's written procedures that prohibited its registered representatives from borrowing money from customers unless the customers are the representative's immediate family members and the representative obtains the firm's prior written permission. The findings stated that the customers were not related and Kellogg had not obtained written permission.

The suspension in any capacity will be in effect from August 7, 2006 through October 5, 2006. **(NASD Case #2005001351501)**

Gerald Lawrence Kells, II (CRD #1465055, Registered Principal, Manlius, 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 20 business days. The fine must be paid before Kells reassociates with a member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Kells consented to the described sanctions and to the entry of findings that he executed securities transactions in a public customer's trust account without the customer's prior knowledge, authorization or consent.

The suspension in any capacity was in effect from July 17, 2006 through August 11, 2006. **(NASD Case #2005003581901)**

Bryon Scott Key (CRD #3012745, Registered Representative, Mt. Pleasant, South Carolina) 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, Key consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Form U4. The findings stated that Key also failed to disclose his interest in a securities account to his member firm and to the firm carrying the account. The findings also stated that Key failed to respond to NASD requests for information and documents. **(NASD Case #2005002663801)**

John William Krysko (CRD #1107749, Registered Representative, Pleasantville, 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 findings, Krysko consented to the described sanction and to the entry of findings that he failed to respond to an NASD request for information. **(NASD Case #2006004154801)**

Benny Jim Land (CRD #2532168, Registered Representative, Wichita Falls, Texas) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Land consented to the described sanctions and to the entry of findings that he forged public customers' signatures and/or initials on various firm application forms and other customer-related firm documents. **(NASD Case #2005001985101)**

Nathan Edward Lubow (CRD #1851414, Registered Principal, Jacksonville, Florida) 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 Lubow reassociates with any NASD member following the suspension noted above, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Lubow consented to the described sanctions and to the entry of findings that he entered into a settlement agreement with public customers in response to a complaint, failed to disclose the settlement agreement to his member firm, and further, failed to satisfy his obligations pursuant to the agreement.

The suspension in any capacity is in effect from August 7, 2006 through August 6, 2007. **(NASD Case #2005001375201)**

Stacey Joe McBee (CRD #2630337, Registered Representative, Suwanee, Georgia) was barred from association with any NASD member in any capacity. The sanctions were based on the findings that McBee opened a securities account with another NASD member firm and failed to disclose to that firm that he was associated with his member firm. The findings stated that he failed to give his member firm written notification that he opened a securities account with another member firm. The findings also stated that

McBee engaged in outside business activities, for compensation, without giving his member firm prompt written notice of his outside business activities. The findings further stated that McBee failed to respond to NASD requests for information and documents. **(NASD Case #E072004088201)**

Anthony Dickson Miller (CRD #2425850, Registered Representative, Dallas, Texas) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$13,000, which includes an \$8,000 disgorgement of ill-gotten gains and restitution of \$3,342 to a public customer, and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the findings, Miller consented to the described sanctions and to the entry of findings that he recommended and effected securities transactions in a public customer's account that were unsuitable in light of the customer's experience, objectives, financial resources and circumstances. The findings stated that Miller effected numerous discretionary transactions in customers' accounts without their prior written authorization and his member firm's prior written acceptance of the accounts as discretionary.

The suspension in any capacity is in effect from July 17, 2006 through September 14, 2006. **(NASD Case #E0620020559-01)**

Nora Lynn Newell (CRD #1765390, Registered Representative, Chattanooga, Tennessee) submitted an Offer of Settlement in which she was barred from association with any NASD member in any capacity. In light of Newell's financial status, no monetary sanctions were imposed. Without admitting or denying the allegations, Newell consented to the described sanction and to the entry of findings that she borrowed funds totaling \$45,000 from public customers and to fund these loans, she recommended and executed the liquidation of various mutual fund holdings in the customers' accounts. The findings stated that Newell falsely represented to the customers that the funds would be used for real estate investments and she would pay the loans with interest. The findings also stated that Newell never made any principal or interest payments on the loans. The findings also included that Newell did not have reasonable grounds for believing that the recommendation to liquidate and the resultant mutual fund sale transactions were suitable for the customers based on their financial situations, investment

objectives or needs. In addition, NASD determined that Newell failed to respond to NASD requests for information. (NASD Case #E052004024601)

Jeffrey Marc O'Brasky (CRD #1342618, Registered Representative, Scottsdale, Arizona) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$20,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before O'Brasky reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, O'Brasky consented to the described sanctions and to the entry of findings that he entered orders for, and caused the execution of, call options transactions in a public customer's account that he was not authorized to trade pursuant to his member firm's procedures and without approval from the trustees of the transactions prior to execution. The findings stated that O'Brasky provided to a principal of the firm an Options New Account Form for approval of options trading in a customer's account without disclosing that the signatures were not genuine, causing one of his member firm's required records to be falsified.

The suspension in any capacity is in effect from July 3, 2006 through July 2, 2008. (NASD Case #E3A20040354-03)

Emil Brian Panzarino, Jr. (CRD #2540399, Registered Representative, Staten Island, New York) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Panzarino consented to the described sanction and to the entry of findings that he received \$877 from a public customer for the purpose of paying the premium on an automobile insurance policy, and rather than apply the funds to the policy, Panzarino kept and used the funds for his personal use and benefit without the customer's knowledge or authorization. The findings stated that Panzarino failed to appear for an NASD on-the-record interview. (NASD Case #ELI20040386-01)

Andrew James Patton (CRD #2428998, Registered Representative, Fort Collins, Colorado) submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 30 business days. Without admitting or denying the allegations, Patton consented to the

described sanctions and to the entry of findings that, in order to induce public customers to purchase long-term callable certificates of deposit (CDs), he made material misrepresentations of fact. The findings stated that Patton inappropriately exercised a "death-put" feature of a brokered CD held in a public customer's estate account.

The suspension in any capacity is in effect from July 17, 2006 through August 25, 2006. (NASD Case #C05050003/C0520050003)

Corey Mark Patick (CRD #2745094, Registered Supervisor, West Covina, California) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Patick reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Patick consented to the described sanctions and to the entry of findings that he failed to timely respond to NASD requests for documents and information.

The suspension in any capacity is in effect from July 17, 2006 through October 16, 2006. (NASD Case #E0220040528-04)

Philip Leighton Regano (CRD #1187182, Registered Representative, Boardman, Ohio) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Regano consented to the described sanction and to the entry of findings that he received \$619,584.87 from public customers to purchase fixed annuities but failed to follow instructions and used the funds for some purpose other than the customers' benefit. The findings stated that Regano created fictitious statements that lulled the customers into believing that their funds were used for their intended purpose. The findings also stated that Regano engaged in private securities transactions without providing prior written notice to his member firm and obtaining written approval from the firm. (NASD Case #E8A2004059501)

Alfred V. Rodriguez (CRD #4278690, Registered Representative, Toms River, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in

any capacity. Without admitting or denying the findings, Rodriguez consented to the described sanction and to the entry of findings that he signed another member firm employee's name on a verification of employment form without the employee's knowledge or authorization, and Rodriguez also falsified his compensation figures on that form. (NASD Case #2006004107901)

Emanuele Anthony Scarso (CRD #2080536, Registered Representative, Brooklyn, New York) was barred from association with any NASD member in any capacity and ordered to reimburse public customers \$74,120.14, plus interest. The sanctions were based on findings that Scarso executed unauthorized transactions in public customers' accounts. (NASD Case #E062003035102)

Frank Nicholas Scott, Jr. (CRD #823248, Registered Representative, Waco, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Scott consented to the described sanction and to the entry of findings that he participated in private securities transactions without notifying his member firm of these transactions and his proposed role therein, and without receiving his member firm's prior written approval to engage in these transactions. The findings stated that Scott failed to respond to NASD requests for information. (NASD Case #20050022435-01)

Imran Nasim Shams (CRD #2648646, Registered Supervisor, Miamisburg, Ohio) submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 60 days, immediately followed by a suspension from association with any NASD member in any supervisory capacity for 90 days. The fine must be paid before Shams reassociates with any NASD member following the suspension in any capacity, or before he requests relief from any statutory disqualification. Without admitting or denying the allegations, Shams consented to the described sanctions and to the entry of findings that he assisted registered representatives in facilitating their clients' efforts to avoid mutual fund restrictions on their market timing activities, and also directly facilitating those efforts, thereby failing to observe high standards of commercial honor and just and equitable principals of trade. The findings stated

that Shams failed to supervise, in that he failed to adequately respond on a timely basis to the red flags regarding the brokers' efforts to assist their clients' deceptive activity.

The suspension in any capacity is in effect from August 7, 2006 through October 5, 2006, and the suspension in any supervisory capacity will be in effect from October 6, 2006 through January 3, 2007. (NASD Case #EAF0301040003)

William Anthony Shriner (CRD #3212618, Registered Representative, Brownsburg, Indiana) was barred from association with any NASD member in any capacity. The sanction was based on findings that Shriner converted \$62,689.19 that belonged to public customer and used the funds for his own use and benefit without the consent or knowledge of the customer. The findings stated that Shriner failed to respond to NASD requests for information and documents. (NASD Case #E8A2004073701)

Raymond Henry Sutterlin (CRD #2517021, Registered Principal, Brooklyn, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$12,000 and suspended from association with any NASD member in a FINOP capacity for 15 business days. The fine must be paid before Sutterlin reassociates with a member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Sutterlin consented to the described sanctions and to the entry of findings that his member, acting through Sutterlin, failed to adequately ensure that the firm's ledgers and other records accurately reflected all of the firm's assets, liabilities and expenses, causing the firm's records to be inaccurate, which violated Section 17 of the SEC Act of 1934 and Rule 17a-3 thereunder. The findings stated that the firm, acting through Sutterlin, filed inaccurate FOCUS reports. The findings also stated that, as a result of failing to adequately track and book various incurred expenses, the firm, while conducting a securities business and acting through Sutterlin, failed to maintain its minimum net capital requirement and to give timely notice to the SEC and NASD, pursuant to SEC Rule 17a-11.

The suspension in a FINOP capacity was in effect from July 3, 2006 through July 24, 2006. (NASD Case #E1020040750-01)

Jonathan Michael Taylor (CRD #4188832, Registered Representative, Reading, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Taylor reassociates with a member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Taylor consented to the described sanctions and to the entry of findings that he signed public customers' names on an updated Suitability Form and Disclosure Check List form without their authorization or consent.

The suspension in any capacity is in effect from July 3, 2006 through October 2, 2006. **(NASD Case #20060036945-01)**

Duane Keith Thelen (CRD #455532, Registered Representative, Comstock Park, Michigan) was barred from association with any NASD member in any capacity. The sanction was based on findings that Thelen failed to respond to NASD requests for information. The findings stated that Thelen received funds from public customers to purchase insurance, but failed to pay the premiums, thereby misusing customer funds. **(NASD Case #E8A20040817-01)**

Joseph Gerald Vitetta (CRD #1536695, Registered Representative, Sea Bright, New Jersey) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity and ordered to pay a public customer \$37,000 in restitution. Without admitting or denying the allegations, Vitetta consented to the described sanctions and to the entry of findings that he made an unsuitable recommendation to a public customer that resulted in a large surrender charge and a forfeiture of a death benefit. The findings stated that Vitetta misappropriated/misused \$37,000 from a public customer. The findings also stated that Vitetta failed to disclose information on his Form U4. **(NASD Case #E1020041225-01)**

Brad Allan Weaver (CRD #2505931, Registered Principal, Chicago, Illinois) was barred from association with any NASD member in any capacity. The sanction was based on findings that Weaver permitted an unregistered person who was also barred from the securities industry to engage in securities transactions. The findings stated that Weaver failed to maintain complete, accurate and current books and records.

The findings also stated that Weaver guaranteed a public customer against loss in his securities account. The findings also included that Weaver engaged in outside business activities, for compensation, without providing his member firm with prompt written notice. **(NASD Case #E8A2004050201)**

Alexander M. Williams (CRD #3046599, Registered Representative, Brooklyn, New York) was barred from association with any NASD member in any capacity. The decision was based on findings that Williams engaged in excessive trading in a public customer's accounts based on the customer's financial circumstances and investment objectives. The findings stated that Williams received funds from a public customer for investment, but instead used the funds to purchase securities in an account he controlled. The findings also stated that Williams failed to respond to NASD requests for information and documents. **(NASD Case #E1020040687-01)**

Fai W. Wong (CRD #2596128, Associated Person, Brooklyn, New York) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Wong consented to the described sanction and to the entry of findings that he converted \$2,175,000 from his member firm for his own use and benefit without the firm's prior knowledge, authorization or consent. The findings stated that Wong failed to appear for scheduled NASD on-the-record interviews. **(NASD Case #2005000464401)**

Decisions Issued

The following decisions have been issued by the Office of Hearing Officers (OHO), and have been appealed to or called for review by the NAC as of July 7, 2006. The NAC may increase, decrease, modify or reverse the findings and sanctions imposed in the decisions. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notice to Members*.

Angel Cruz (CRD #1988787, Registered Principal, San Francisco, California), Anthony Joseph Martinez (CRD #1568443, Registered Principal, Lake Grove, New York) and Jericho Guazon Nicolas (CRD #2030192, Registered Representative, San Francisco, California) were barred from association with any NASD member in any capacity. The sanctions were

based on the findings that the respondents effected trades in a public customer's accounts by interpositioning their firm between the customer and the market and taking intra-day trading profits on riskless principal transactions. The findings stated that the respondents caused their member firm to send trade confirmations to a customer that failed to disclose the firm's intra-day trading profits on the transactions the respondents effected. The findings also stated that Martinez failed to give the customer best execution when he caused the firm to take trading profits on these principal trades, and failed to provide the customer with best execution when he executed trades at prices less favorable than the prevailing inter-dealer price at the time of the trade. The findings also included that the respondents failed to make and keep, or caused their firm to fail to make and keep, accurate records of each of the customer's orders showing the orders' terms and conditions. NASD found that Martinez reported or confirmed riskless principal transactions as principal transactions without submitting, or causing his firm to submit, either a clearing-order report with a capacity indicator of "riskless principal" or a non-tape, non-clearing report with a capacity indicator of "riskless principal."

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #CAF040052)

Hung The Nguyen (CRD #2532462, Registered Representative, Orlando, Florida) 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 Nguyen reassociates with any NASD member following the suspension noted above, or before he requests relief from any statutory disqualification. The sanctions were based on the findings that Nguyen failed to disclose to his member firm his activities relating to an outside securities account. (NASD Case #E072004087801)

Frank Peter Quattrone (CRD #1312126, Registered Principal, Los Altos Hills, California). The United States Securities and Exchange Commission (SEC) set aside the NAC's decision barring Quattrone from association with any NASD member in any capacity for failing to appear for an on-the-record testimony. (NASD Case #CAF030008)

Complaints Filed

NASD issued the following complaints. Issuance of a disciplinary complaint represents NASD's initiation of a formal proceeding 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.

Melissa A. Licht (CRD #4470617, Registered Representative, Pittsburgh, Pennsylvania) was named as a respondent in an NASD complaint alleging that she took blank checks pertaining to an account her supervisor owned, made the checks payable to herself for a total amount of \$8,500, forged her supervisor's signature on the checks, and endorsed and deposited them into her personal bank account without her supervisor's authorization or consent. The complaint alleges that Licht failed to respond to NASD requests for information. (NASD Case #2005002708301)

George Ellis Brown McMahon III (CRD #3055065, Registered Representative, Waldorf, Maryland) was named as a respondent in an NASD complaint alleging that he received checks from public customers for investment purposes, negotiated the checks but did not invest the money as the customers instructed. The complaint also alleges that McMahon failed to respond to NASD requests for information or documents. (NASD Case #2005003051001)

Scott Thomas Powers (CRD #2255877, Registered Representative, Danvers, Massachusetts) was named as a respondent in an NASD complaint alleging that he accepted a \$25,000 bank check from a public customer for investment purposes and deposited the funds into a bank account, but did not use the funds to purchase securities and has not repaid the customer. The complaint alleges that Powers failed to respond to NASD requests for information and documents. (NASD Case #2005002808001)

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

May, Davis Group Inc.
New York, New York
(June 29, 2006)

World Financial Capital Markets Inc.
(nka New World Financial, Inc.)
Marbella, Spain
(June 29, 2006)

Firms Suspended Pursuant to NASD Rule 9553 for Failure to Pay Arbitration Fees

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

Benson York Group, Inc.
Melville, NY
(July 5, 2006)

Stipek Securities, LLC
Santa Anna, CA
(July 5, 2006)

Firm Suspended Pursuant to NASD Rule Series 9554 for Failure to Comply with an Arbitration Award or a Settlement Agreement

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

Stipek Securities, LLC
Santa Ana, California
(July 18, 2006)

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

Christopher John Borgo
Boca Raton, Florida
(June 29, 2006)

Jeffrey Stuart Goldberg
Hillside, New Jersey
(June 29, 2006)

Marc Alan Levy
Boynton Beach, Florida
(June 29, 2006)

Individuals Barred Pursuant to NASD Rule 9552(h)

Russell Rodney Cloward
West Jordan, Utah
(July 24, 2006)

E. James Pritchett
Metairie, Louisiana
(July 31, 2006)

Claude St. Jean
Tampa, Florida
(July 31, 2006)

Richard Wolfe Weinberg
Oxnard, California
(July 17, 2006)

Individuals Suspended Pursuant to NASD Rule 9552(d)

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

Mohammed Kariuki Ali
Hackensack, New Jersey
(July 5, 2006)

Faith Yvette Dove
Bronx, New York
(July 31, 2006)

David Lee McMillan
Bullhead City, Arizona
(July 17, 2006)

Omar Rodriguez
Perth Amboy, New Jersey
(July 17, 2006)

Individuals Suspended Pursuant to NASD Rule Series 9554 for Failure to Comply with an Arbitration Award or a Settlement Agreement

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

Thomas McDermott Head

Palm Desert, California

(September 15, 2004, to July 13, 2006)

Camie Moen Quigley

Inver Grove Heights, Minnesota

(July 31, 2006)

Leslie Clark Stipek

Santa Ana, California

(July 18, 2006)

NASD Hearing Panel Bars Municipal Securities Broker for Fraudulent Sales Practices

Founder of California Firm Ordered to Repurchase Bonds, Pay Restitution to Customers

An NASD Hearing Panel has barred Marshall J. Field of Woodland Hills, CA, from the securities industry for fraudulent sales of municipal securities and for making unauthorized transactions in customer accounts.

The panel also ordered monetary sanctions against Field, the majority owner of now-defunct American National Municipal Corp. Field must offer rescission for transactions—that is, he must offer to repurchase bonds he sold customers at the original purchase price—totaling approximately \$422,000. Field must also pay restitution of approximately \$63,000, plus interest, to investors who suffered losses because of his misconduct.

The Hearing Panel found that from January 1999 through October 2002, Field made intentional misrepresentations and omissions of material fact to customers in recommending the purchase and sale of eight special, limited obligation bonds that were not backed by any public agency. Instead, they were payable solely from the anticipated revenues of the projects the bonds were funding—including a housing project and a golf course. The prospectus and official statement for each bond explicitly cautioned that investing in the bond involved substantial risks—including the potential loss of the entire investment, since anticipated revenues might be insufficient to pay the principal and/or interest; and because the underlying project was dependent on a developer/consultant with a limited operating history and no independent sources of revenues. The official statements also noted that the bonds could lose their tax-exempt status.

Nevertheless, Field promoted the bonds as safe and secure investments offering generous interest, the panel found. He did not inform his customers that the bonds were special, limited obligations, he did not disclose the risks associated with them, and he failed to furnish his customers with official statements or prospectuses that accurately described the bonds and their risks—even when customers specifically requested those documents.

Field also failed to disclose to his customers, either orally or through the delivery of official statements or prospectuses, that the State of California and the Securities and Exchange Commission (SEC) had accused the managing underwriter for each of the bonds and two of its principal officers of securities law violations in connection with municipal securities offerings associated with developments in California.

The Hearing Panel noted that Field targeted unsophisticated, vulnerable, often elderly customers who relied on him for investment advice. Most of the customers contacted Field after seeing his television advertisements extolling the safety and security of municipal bonds. But “rather than recommend safe and reliable investments,” the panel wrote in its decision, Field induced his customers “to invest in speculative municipal bonds that were underwritten by a firm and its principals who had been accused by state and federal regulatory authorities of securities fraud.”

The panel also found that Field executed a total of eight unauthorized transactions, most involving both an unauthorized purchase and an unauthorized sale, in the accounts of six different investors. The Hearing Panel found that the unauthorized transactions were accompanied by deception about the nature of the bonds and the reasons for the unauthorized transactions. Finally, the Hearing Panel found that Field guaranteed an investor against loss in connection with her purchase of a municipal security.

The Hearing Panel found that Field violated federal securities laws and Municipal Securities Rulemaking Board (MSRB), which NASD enforces. Noting the egregious nature of the violations and that Field has not accepted responsibility for his misconduct, the panel said it “believes that to remediate the misconduct and to protect the investing public, Field should be barred from associating with any (registered firm) in any capacity”—NASD’s most severe sanction for an individual. The panel ordered restitution and rescission to customers as well.

This Decision has been appealed to the National Adjudicatory Council (NAC), and the sanctions are not in effect pending consideration of the appeal.

NASD Fines Two Firms and Eight Traders \$490,000 for Misusing NASDAQ Trading System

Traders Entered Improper Orders in Pre-Open Market; Firms Failed to Supervise

NASD fined Trillium Trading LLC of Edison, NJ, eight Trillium traders and Schonfeld & Company LLC of Jericho, NY, a total of \$490,000 for entering improper crossed quotes during the NASDAQ Stock Market’s opening. Trillium Trading was fined \$225,000. Schonfeld & Company was fined \$175,000. The eight traders received fines ranging from \$10,000 to \$20,000 as well as suspensions ranging from one to four months.

“NASD will react quickly and aggressively when market participants attempt to distort market processes,” said Stephen Luparello, NASD’s Senior Executive Vice President for Market Regulation.

In October 2004, NASDAQ introduced the Modified Opening Process (MOP) so that markets would be unlocked and uncrossed at the open, thereby promoting the price discovery process. An NASD investigation found that during the first week of the MOP, eight Trillium traders and certain Schonfeld customers devised and implemented an impermissible trading strategy that allowed them to receive favorable executions in the MOP. Specifically, under the MOP, the first eligible orders submitted after 7:30 a.m. got the first available executions at 9:25 a.m. Thus, as soon after 7:30 a.m. as possible, in order to be first in line in the queue for executions at 9:25 a.m., the Trillium traders and Schonfeld customers entered two orders, a bid and an offer, in a same security, each of which crossed the market. At the time the traders and customers entered the orders, they did not know in which direction the market would move and thus did not know whether it would be beneficial to buy or sell the security. By placing orders simultaneously on opposite sides of the market in this fashion, the traders and customers were able to position themselves to obtain favorable executions regardless of whether the market moved up or down. The Trillium traders and Schonfeld customers never intended to both buy at the bid and sell at the offer. Rather, they intended to cancel one of the orders, either the bid or the offer, and leave only the order likely to get a favorable execution at 9:25 a.m. The strategy worked only if the traders and customers intended from the beginning to cancel one of the quotations. NASD rules prohibit the publication of non-bona fide quotations.

The non-bona fide orders—which were placed in over 1,000 different securities over two weeks—also adversely affected price discovery during the pre-open hours.

NASD also found that Trillium did not adequately supervise the activity of its traders during the MOP and that Schonfeld failed to supervise the activity of its retail day traders, who are not registered with NASD.

In concluding these settlements, the firms and traders neither admitted nor denied the charges, but consented to the entry of NASD’s findings. The firms and individuals agreed to the following sanctions:

Trillium Trading LLC	a censure, a \$225,000 fine (\$175,000 for supervision violations and \$50,000 for improper quotation practices by its traders) and an undertaking to revise its written supervisory procedures
Schonfeld & Company LLC	a censure, a \$175,000 fine (for supervision violations) and an undertaking to revise its written supervisory procedures
Imran Ahmad	a \$10,000 fine and a two-month suspension
Feming Chan	a \$20,000 fine and a two-month suspension
John R. Chinnock	a \$10,000 fine and a four-month suspension
Cary S. Grill	a \$10,000 fine and a one-month suspension
Zachary G. Hepner	a \$10,000 fine and a three-month suspension
David B. Lazarus	a \$10,000 fine and a two-month suspension
David E. Schwarz	a \$10,000 fine and a one-month suspension
Nikolas Z. Vrettos	a \$10,000 fine and a two-month suspension

NASD Fines Citigroup, Credit Suisse and Morgan Stanley \$775,000 For Deficient Price Target, Ratings, Other Disclosures in Research Reports

Firms Ignored Warnings from NASD to Cease Violating Analyst Disclosure Rules

NASD imposed fines totaling \$775,000 against Citigroup Global Markets, Inc., Credit Suisse Securities (USA), LLC (formerly Credit Suisse First Boston, LLC) and Morgan Stanley & Co. Incorporated for numerous violations of NASD’s research analyst conflict of interest rules.

NASD fined Citigroup \$350,000, Credit Suisse \$225,000 and Morgan Stanley \$200,000. In addition to the fines, Citigroup and Credit Suisse agreed to review research reports and certify to NASD that they contain proper disclosure of price target valuation methods and risks. Those reviews and certifications must take place quarterly, for one year.

“The failures on the part of Citigroup, Credit Suisse and Morgan Stanley to abide by these rules undermine the important disclosure obligations mandated by NASD in the wake of the research analyst conflict of interest scandals,” said James S. Shorris, Executive Vice President and Head of Enforcement. “These cases should send a clear message to firms that NASD expects full compliance with the research disclosure requirements, especially after NASD notifies a firm that its practices violate our rules.”

Citigroup

NASD found that from July 2002 to May 2005, Citigroup failed to include in more than 2,500 technical and quantitative research reports numerous disclosures required by NASD’s research analyst conflict of interest rules. In June 2004, NASD’s Advertising Department found that Citigroup’s research did not contain the required disclosures, a finding that the firm acknowledged. At that time, NASD instructed Citigroup that it must bring its research into compliance and reiterated this position in a December 2004 meeting. The firm’s delinquent efforts to comply with NASD disclosure rules were hampered by a lack of effective or timely corporate support, including the failure of the firm to commit adequate funds or resources. Lacking sufficient funds and without a game plan for completion, Citigroup’s efforts were characterized in

a June 2004 internal email as being “in limbo.” Citigroup did not bring its research into compliance with NASD disclosure rules until May 2005, more than two years after the effective date of these rules.

Credit Suisse

NASD found that from February 2003 to November 2005, Credit Suisse regularly published equity research reports that violated NASD price target disclosure rules by using unclear language to describe price target valuation methods and the risks that might impede achievement of the price target. During that time, Credit Suisse published approximately 11,000 research reports per year. The firm continued to publish research reports containing deficient price target disclosures despite two warnings by NASD Advertising in February 2003 and August 2004. Credit Suisse also failed to enforce its written procedures concerning price target disclosures.

Morgan Stanley

NASD found that from March 2003 to June 2004, Morgan Stanley published over 22,000 equity research reports that failed to disclose, in a clear and prominent manner, the percentage of securities to which it would assign a “buy,” “hold/neutral” or “sell” rating as NASD rules requires. Additionally, from March 2003 to July 2005, Morgan Stanley published 21,000 equity research reports that failed to adequately disclose so-called “analyst industry view” ratings—a rating system used to measure the performance of the analyst against a selected broad market benchmark, such as the S&P 500. Throughout these time periods, Morgan Stanley received repeated notices from NASD Advertising that their research reports failed to comply with applicable disclosure rules, yet the firm failed to take reasonable or prudent steps to correct these deficiencies.

In connection with these settlements, Citigroup, Credit Suisse and Morgan Stanley neither admitted nor denied the charges, but consented to the entry of NASD’s findings.