

FEBRUARY 2007

Notice to Members

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Disciplinary and Other NASD Actions



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Notice to Members

FEBRUARY 2007

SUGGESTED ROUTING

Corporate Financing
Legal and Compliance
Senior Management
Operations
Corporate Financing
Fees

KEY TOPICS

Public Offerings
Rule 2710
Rule 2720
Schedule A to NASD By-Laws
Well-Known Seasoned Issuers (WSKIs)

GUIDANCE

Corporate Financing Fee

Amendments to the Fees for Filing Offering Documents by Well-Known Seasoned Issuers Pursuant to the Corporate Financing Rule; **Effective Date: February 26, 2007**

Executive Summary

On January 24, 2007, NASD filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a rule change to amend Section 7 of Schedule A to NASD's By-Laws to adjust the fees for filing offering documents by "well-known seasoned issuers" pursuant to Rule 2710 (Corporate Financing Rule – Underwriting Terms and Arrangements).¹

Section 7 of Schedule A to NASD's By-Laws, as amended, is set forth in Attachment A of this *Notice*. The amendments will be implemented on February 26, 2007.

Questions/Further Information

Questions regarding this *Notice* may be directed to Joani Ward, Assistant Director, Corporate Financing Department, at (240) 386-4649; or Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

Background and Discussion

Under Section 7 of Schedule A to the NASD By-Laws, the fee for filing offering documents with NASD pursuant to Rule 2710 is equal to \$500 plus .01% of the proposed maximum aggregate offering price or other applicable value of all securities registered, but not to exceed \$75,500.² However, as part of the SEC's Securities Offering Reform,³ which became effective on December 1, 2005, the rules permit, among other things, "well-known seasoned issuers" or

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“WKSIs” to file automatically effective shelf registration statements without specifying the amount or value of the securities that may be offered off the registration statement for up to three years.⁴

Since the NASD filing fee is based on the proposed maximum aggregate offering price on an SEC registration statement, assessing the fee on filings by WKSIs has been problematic because WKSIs are not required to specify a proposed maximum aggregate offering price or other applicable value on the registration statement. In view of the fact that a WKSI shelf registration filing allows the issuer to offer registered securities for a three-year period in amounts that may exceed \$750 million, NASD is imposing the maximum filing fee on all WKSI filings.⁵

Accordingly, NASD has amended Section 7 of Schedule A to the NASD By-Laws expressly to require that the fee imposed for the filing of offering documents that are required to be filed with NASD relating to an automatically effective Form S-3 or F-3 registration statement filed with the SEC and offered pursuant to SEC Rule 415 by a WKSI shall be \$75,500.

The implementation date of the amendment will be February 26, 2007.

Endnotes

- 1 See SR-NASD-2007-006 filed on January 24, 2007. Under Section 19(b) of the Securities Exchange Act of 1934, the SEC has the authority to summarily abrogate this type of rule change within 60 days of filing.
- 2 Thus, under Section 7 of Schedule A to the NASD By-Laws, fees are capped with respect to offerings with an aggregate offering price of \$750 million or more.
- 3 See Securities Exchange Act Release No. 52056 (July 19, 2005), 70 FR 44722 (August 3, 2005).
- 4 WKSIs are large issuers that generally must have either \$700 million of worldwide equity market capitalization or an aggregate of \$1 billion of non-convertible securities issued within the past three years. See SEC Rule 405.
- 5 NASD's electronic filing system does not track subsequent amendments to WKSI registration statements to determine whether new securities have been registered by an amendment, thereby increasing the size of the offering. Moreover, if multiple members participate in takedowns of securities off of a WKSI shelf registration statement over time, no one member would have the ability to track the aggregate value of the securities sold by the multiple members and ensure that the proper filing fee is paid in connection with the offerings.

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ATTACHMENT A

New language is underlined; deletions are in brackets.

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SCHEDULE A TO NASD BY-LAWS

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Section 7 — Fees for Filing Documents Pursuant to the Corporate Financing Rule

(a) There shall be a fee imposed for the filing of initial documents relating to any offering filed with NASD pursuant to the Corporate Financing Rule equal to: (1) \$500 plus .01% of the proposed maximum aggregate offering price or other applicable value of all securities registered on an SEC registration statement or included on any other type of offering document (where not filed with the SEC), but shall not exceed \$75,500; or (2) \$75,500 for an offering of securities on an automatically effective Form S-3 or F-3 registration statement filed with the SEC and offered pursuant to SEC Rule 415 by a Well-Known Seasoned Issuer as defined in SEC Rule 405. The amount of the filing fee may be rounded to the nearest dollar.

(b) No Change.

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SUGGESTED ROUTING

Executive Representatives
Legal and Compliance
Operations
Senior Management
Mutual Funds
Registered Representatives

KEY TOPICS

Rule 11870
Supervision
Variable Products

GUIDANCE

Supervision of Recommendations after a Registered Representative Changes Firms

Special Considerations When Supervising Recommendations of Newly Associated Registered Representatives to Replace Mutual Funds and Variable Products

Executive Summary

Registered representatives with an established customer base may, from time to time, change their association from one firm to another and may wish to bring with them customer assets, including mutual funds and variable products. In some cases these mutual funds or variable products may be held directly with the product issuer or they may be proprietary to the representative's prior firm and the sponsor may not permit them to be transferred into the customer's account at the new firm. Even nonproprietary products may not be freely transferable if the sponsor does not have a dealer or servicing agreement with the new firm.

In cases such as these, the new firm may not sell or in some cases even service the investment or receive trail commissions from the distributor. In these situations, the representative may be inclined to recommend the liquidation and replacement of the customer's investments with other, similar investments. Although the ability to provide the customer with service in connection with an investment can be a relevant factor to consider in connection with the decision whether to retain the investment, any recommendation by the firm or its associated persons to sell a product and to replace it with another one may be made only after fully assessing the suitability of the transaction for the customer and determining that the transaction is in the customer's best interests in view of all considerations. Member

firms and their associated persons may not reach any suitability determination or make any recommendation on the basis that the purchase of a security or sale and replacement of a security will yield greater remuneration for them. Moreover, the representative should disclose to the customer all of the relevant facts and bases for the recommendation. See, e.g., *Notice to Members 99-35* (May 1999).

Questions/Further Information

Questions concerning this *Notice* should be directed to Kosha K. Dalal, Associate General Counsel, Office of General Counsel, at (202) 728-6903.

Background and Discussion

It is not uncommon for an individual registered representative or a group of representatives with an established customer base to terminate their association with one firm in favor of another. In such instances, one of the principal interests of the acquiring firm is ensuring that the newly associated representatives retain as much as possible of the customer base they serviced. Depending upon the nature of the business in which the representative was engaged, a number of the customers he or she serviced may own mutual funds and variable products that the prior firm was authorized by a sponsor to sell and service pursuant to a dealer or servicing agreement. The agreements frequently require that the sponsor pay the prior firm various distribution, marketing and/or servicing fees, also referred to as "trail commissions," which may benefit the representative.

When a representative who has sold such a product chooses to associate with a new firm, however, there may be impediments to the representative's ability to continue selling or servicing these investments, as well as receiving trail commissions from the sponsor for products the representative previously sold or serviced. For example, the product might be held directly with the issuer, it might be proprietary to the customer's prior firm and not portable, or the product sponsor might not permit the product to be transferred to the customer's account at the new firm. Even in the case of nonproprietary products, the new firm might not have a dealer or servicing agreement with the sponsor.¹ In other cases, the new firm may have such an agreement, but the representative's new firm may not be able to receive trail commissions on previously sold business because those trail commissions contractually belong to the previous firm that sold the product and it might not agree to relinquish them to the representative's new firm.

In these situations, the transferring representative may be tempted to recommend to customers that they replace their existing mutual funds and variable products with other investments, without adequately considering the customer's best interests and the suitability for the customer of those recommendations. Such inappropriate recommendations might be premised upon the fact that the new firm or the representative will no longer receive trail commissions for the customer's current investments or that the representative will generate more income by replacing an investment than recommending that the customer continue to hold the investment through the representative's prior firm.

A recommendation to liquidate, replace or surrender an existing investment must be suitable and based upon the customer's investment needs and not the financial needs of the firm or its associated persons. See, e.g., *Notice to Members 99-35* (May 1999).² A firm may consider the fact that the firm lacks a dealer or servicing agreement with the product sponsor and, therefore, the registered representative cannot provide the customer with the service that the customer desires with respect to the product. The suitability analysis must also include other considerations, however, including whether the customer's mutual fund or variable product is subject to a contingent deferred sales charge or a required holding (surrender) period, or has other features that materially affect its value or liquidity, and the fees and expenses associated with the new product being recommended. Accordingly, firms should have procedures in place, including supervisory procedures, that are specifically designed to review and evaluate investment recommendations relating to mutual funds and variable products that are made by newly associated persons to their existing customers. See NASD Rule 3010 and *Notice to Members 99-45* (June 1999).

These procedures should include at least the following:

- ▶ When conducting due diligence concerning a prospective new registered representative, the new firm should seek to learn the nature of the representative's business and the extent to which he or she offers investment products for which the new firm would need a dealer or servicing agreement in order for the representative to sell and provide service. The new firm should determine whether it would seek such agreements.
- ▶ If the new firm is unable or unwilling to service a customer's mutual fund or variable product, the new firm or the registered representative should advise the customer of this fact, as well as the options the customer may have to continue to hold the investment at the customer's prior firm, before recommending that the customer liquidate or surrender the investment.³

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- ▶ Any recommendation to liquidate, replace or surrender a mutual fund or variable product must be suitable for the customer based upon the customer's financial needs and investment objectives. Recommendations should not be a function of the desire of the firm or its new representative to obtain compensation that it would not otherwise receive were the customer to retain the previously sold investment.
 - ▶ For a reasonable period following the association of a new representative, the new firm should review replacements recommended by the associated person with a view to identifying any recommendations to liquidate or surrender mutual funds or variable products that may be inconsistent with the customer's investment needs and objectives or that have not been preceded by appropriate disclosure to the customer. Special supervisory consideration should be given to those transactions involving the replacement of a customer's existing variable annuity product with a "bonus variable annuity" offered by the new firm.⁴ The firm should review these transactions with a view to ensuring that full disclosure is made to the customer regarding all fees, expenses and surrender charges that may apply to the replacement product; a "bonus" on premium payments may not be considered an "offset" against any other fees or expenses, including surrender charges applied to the replaced product.⁵

Endnotes

- 1 Rule 11870 of the Uniform Practice Code (Customer Account Transfer Contracts) addresses the transfer of assets held in a customer's securities account. While the rule provides that member firms must, upon a customer's request, expedite and coordinate the transfer of securities account assets from a carrying firm (*i.e.*, the customer's current firm) to a receiving firm (*i.e.*, the customer's new firm), the rule identifies several categories of securities as "non-transferable assets," including, but not limited to, an asset that is a proprietary product of the carrying member, as well as an asset that is "a product of a third party ... with which the receiving member does not maintain the relationship or arrangement necessary to receive/carry the asset for the customer's account...." See Rule 11870(c)(1)(D). In such instances, Rule 11870(c)(3) provides that where the non-transferable product is proprietary to the customer's carrying firm, the carrying firm must notify the client of the status of the non-transferable asset and seek instructions as to whether to liquidate the product, continue holding it for the customer's benefit or deliver it to the customer. Similarly, Rule 11870(c)(4) provides that where the customer's receiving firm cannot accept a product because, for example, the receiving firm does not have a servicing agreement with the product sponsor, the receiving firm must notify the customer and seek instructions as to whether to liquidate the product, leave the product with the carrying firm for the customer's benefit, deliver it to the customer or deliver it to the product issuer to hold for the customer's benefit.
- 2 "The registered representative and the registered principal should determine, based on the information provided by the customer and their own knowledge of the product features, that replacing the existing contract with a new contract is suitable for the customer. Consideration should be given to such matters as product enhancements and improvements, lower cost structures, and surrender charges."
- 3 See *also supra* note 1 discussing transfer requirements under Rule 11870.
- 4 A bonus variable annuity offers premium credits toward the value of the variable annuity contract at a specified percentage usually ranging between 1 percent and 5 percent of the purchase payment made.
- 5 The guidance set forth in this *Notice* would also apply in those situations in which a firm or its registered representative attracts a new customer who has mutual fund or variable product holdings with his prior firm. In such cases, the customer's new firm and representative must be cognizant of the aforementioned when making recommendations that concern these holdings.

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SUGGESTED ROUTING

Legal and Compliance
Registered Representatives
Senior Management
Training

KEY TOPICS

Arbitration
Code of Arbitration Procedure
Dispute Resolution
Mediation

GUIDANCE

Code of Arbitration Procedure

SEC Approves Revision of Customer and Industry Portions of NASD Code of Arbitration Procedure; **Effective Date: April 16, 2007**

Executive Summary

The Securities and Exchange Commission (SEC) has approved the NASD Codes of Arbitration Procedure for Customer and Industry Disputes (hereinafter referred to as the Customer and Industry Codes, respectively, or new Codes).¹ The Customer and Industry Codes reorganize the dispute resolution rules into separate procedural codes, simplify the language of the NASD Code of Arbitration Procedure (old Code), codify current practices and implement several substantive changes.

The Customer and Industry Codes can be accessed on the NASD Web site at the following links: www.nasd.com/rulefilings/customercode and www.nasd.com/rulefilings/industrycode. The Customer and Industry Codes will become effective on April 16, 2007, and will apply to claims filed on or after the effective date.²

In addition, the list selection provisions of the new Codes will apply to previously filed claims in which a list of arbitrators has not yet been generated and sent to the parties, or in which an entirely new list of arbitrators must be generated.³ In these cases, even though a list has been generated under the new Customer or Industry Code, the claim will continue to be governed by the remaining provisions of the old Code unless all parties agree to proceed under the new Code.

Questions/Further Information

Questions regarding this *Notice* may be directed to Jean Feeny, Vice President and Chief Counsel, NASD Dispute Resolution, at (202) 728-6959; or Mignon McLemore, Assistant Chief Counsel, NASD Dispute Resolution, at (202) 728-8151.

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Summary of Key Changes

The new Codes benefit investors, brokerage firms, associated persons and other users of the forum in important ways. For example:

- ▶ The new Codes contain a new rule that defines commonly used terms applicable throughout the new Codes (Rule 12100 of the Customer Code and Rule 13100 of the Industry Code). In the old Code, some rules, such as old Rule 10308, contained definitions applicable to the rule only, but there was no general definitions rule that applied to the entire Code. The comprehensive definitions rule makes the new Codes easier to understand and to use, and helps eliminate confusion about the meaning and scope of frequently used terms.
- ▶ The new Codes give parties more flexibility and control over the arbitration process by clarifying which deadlines can be extended and establishing straight-forward procedures under the rules to exercise this option. Under the new Codes, parties may agree in writing to extend or modify any deadlines for serving an answer, returning arbitrator or chairperson lists, responding to motions, or exchanging documents or witness lists (Rule 12207 of the Customer Code and Rule 13207 of the Industry Code).
- ▶ The new Codes centralize the panel's authority to sanction parties for failure to comply with any provision of the Code or order of the panel (Rule 12212 of the Customer Code and Rule 13212 of the Industry Code). Also, the new Codes codify the sanction options available to arbitrators as currently described in the NASD Discovery Guide, and extend them beyond the discovery context to apply to non-compliance with any order of the panel or provision of the Codes.
- ▶ The new Codes improve the arbitrator selection process by:
 - using a new computer system—developed in conjunction with the new Codes to modernize the selection process—to generate lists of arbitrators on a random rather than rotational basis (Rule 12400 of the Customer Code and Rule 13400 of the Industry Code);
 - creating and maintaining a new roster of arbitrators who are qualified to serve as chairpersons. The chair roster consists of more experienced arbitrators available on NASD's public arbitrator roster for all investor cases (Rule 12400(b) and (c) of the Customer Code) and for certain intra-industry cases (Rules 13400(b)-(c) and 13402(b) of the Industry Code). For other industry cases, the Code also creates a chair roster of experienced non-public arbitrators (Rules 13400(b)-(c) and 13402(a) of the Industry Code);⁴ and
 - expanding the number of names on lists of potential arbitrators for a panel, but limiting the number of strikes each separately represented party may use to select potential arbitrators for a panel from a list of potential arbitrators (Rule 12404 of the Customer Code and Rule 13404 of the Industry Code).

These changes, discussed in more detail below, will give parties more control over which arbitrators are selected for panels, ensure that the panels will contain experienced arbitrators, and improve the efficiency of case administration.

- ▶ The Customer Code codifies the discovery procedures currently outlined in the NASD Discovery Guide, with certain substantive changes (Rules 12505 - 12511 of the Customer Code). The Customer Code makes it clear that producing or objecting to documents on the Document Production lists described in the Discovery Guide, as well as other documents requested by parties, is mandatory. In addition to this change, the Customer Code codifies the sanctions provisions of the Discovery Guide, clarifying the authority of arbitrators to penalize parties for non-compliance with discovery rules or orders of the panel. Collectively, these changes, discussed in more detail below, should significantly reduce the number of discovery disputes in NASD arbitrations involving customer disputes.
- ▶ Under the new Codes, we revised the fee schedules to minimize confusion concerning filing fee requirements and to make them easier to read (Rules 12900 - 12903 of the Customer Code and Rules 13900 - 13903 of the Industry Code). NASD changed the fee schedules in two significant ways by:
 - combining the filing fee and the hearing session deposit into one single fee that the claimant pays when a claim is filed; and
 - condensing several sets of fee brackets in the filing fee schedule.

These changes, discussed in more detail below, greatly simplify the fee schedule, eliminate three repetitive high-end brackets, and align the brackets in the filing fee schedule with the brackets in the member filing fee and surcharge schedules.

The structural and substantive changes under the new Codes make the NASD arbitration process simpler and more uniform and transparent.

Background and Discussion

In 1998, the SEC launched an initiative to encourage issuers and self-regulatory organizations to use “plain English” in disclosure documents and other materials used by investors. Under the initiative, the SEC recommended using shorter, more common words, breaking long rules into shorter ones, using the active voice whenever possible and putting lists into easy-to-read formatting, such as bullet points.

Because investors, including investors who appear *pro se* (that is, investors who represent themselves) used the old Code in the NASD forum, NASD undertook to rewrite the old Code in plain English. In revising the old Code, NASD implemented the plain English guidelines wherever possible. For example, NASD simplified language and eliminated unnecessarily legalistic terminology. We also broke up long rules, such as old Rule 10308 governing arbitrator selection, into several shorter rules. Where appropriate, the rules show lists in bullet point format, and use active verbs.

During the course of rewriting the old Code, the goals of the plain English initiative expanded beyond simplifying the language and sentence structure of the rules to include structural and substantive changes. While revising the old Code, NASD decided to:

- ▶ Reorganize the provisions in a more logical, user-friendly way, including creating separate Codes for customer and industry arbitrations, and for mediations;
- ▶ Codify several common practices to provide more guidance to parties and arbitrators; and
- ▶ Implement several substantive rule changes to streamline the administration of arbitrations in the NASD forum.

Reorganization

Users of the old Code frequently complained about its organization. Parties, particularly infrequent users of the forum, had difficulty finding the rules they were looking for because the rules were not in the expected order of an arbitration case, and the titles were not always informative. In addition, certain rules in the old Code applied only to customer cases, other rules applied only to industry cases, and some rules applied to both, causing confusion. To address this concern, we reorganized the old Code into three separate procedural codes: the Customer Code, the Industry Code and the Mediation Code.⁵

NASD renumbered the three procedural codes, and each code has been assigned a separate numbering series. The Customer Code is in the 12000 series; the Industry Code is in the 13000 series; and the Mediation Code is in the 14000 series. The old Code's 10000 series will continue to be used for pending cases until they close.

Most rules of the Customer and Industry Codes are identical, except for panel composition, references to document production lists that apply only in customer cases, and rules relating to employment discrimination and injunctive relief that apply only to industry claims. Wherever possible, the last three digits of the rule numbers in the Customer and Industry Codes are the same. For example, under the Customer Code, the rule governing payment of arbitrators is Rule 12214; under the Industry Code, the same rule is Rule 13214.

In addition, the new Codes are organized in a manner that approximates the chronological order of a typical arbitration proceeding. Specifically:

- ◆ Part I contains a definitions rule, as well as rules relating to the organization and authority of the forum;
- ◆ Part II contains general arbitration rules, including what claims are subject to arbitration in the NASD forum;
- ◆ Part III contains rules explaining how to initiate a claim, how to respond to a claim, how to amend claims, and when claims may be combined and separated;
- ◆ Part IV contains rules relating to the appointment, authority and removal of arbitrators;
- ◆ Part V contains rules governing the prehearing process, including new rules relating to motions and discovery;
- ◆ Part VI contains rules relating to hearings;
- ◆ Part VII contains rules relating to the dismissal, withdrawal, or settlement of claims;
- ◆ Part VIII contains the simplified (small cases) arbitration rules (and in the Industry Code only, rules relating to statutory employment discrimination claims and injunctive relief); and
- ◆ Part IX contains rules relating to awards and fees.

New Rules Codifying Well-Established Procedures

The new Codes include as new rules certain common practices in the NASD forum that were not part of the old Code. The most significant of these practices involves motion practice.

Motions Practice

Motion practice has become routine in NASD arbitration, but the old Code was silent with respect to motions. As a result, arbitrators made individual decisions as to how to deal with motions submitted by the parties. New Rules 12503 and 13503 establish uniform procedures for filing, responding to and ruling on motions in NASD arbitrations.

The new Codes do not address expressly motions to decide claims before a hearing on the merits (dispositive motions). NASD filed a proposal with the SEC in July 2006 to adopt Rules 12504 and 13504 to address dispositive motions.⁶ In the interim, Rules 12503 and 13503 will govern all motions, including dispositive motions, except that a party's response to a dispositive motion will not be due until the panel sets a deadline for the response. This approach is consistent with current practice, which will apply to dispositive motions until decisions are made with respect to the status of Rules 12504 and 13504.

Other new rules codifying current practice include:

- ▶ An *ex parte* communication rule (Rules 12210 and 13210), prohibiting a party from one-sided communications with arbitrators, unless otherwise permitted by the new Codes.⁷
- ▶ A sanction rule (Rules 12212 and 13212), codifying arbitrator authority to sanction parties for failing to comply with the Codes or with orders of the panel.
- ▶ Hearing location rules. For customer disputes, the rule codifies NASD's current practice of generally selecting the NASD hearing location closest to the customer's residence at the time of the events giving rise to the dispute (Rule 12213). For industry disputes involving an associated person, NASD generally will select the hearing location closest to where the associated person was employed at the time of the dispute (Rule 13213). If the dispute involves more than one associated person, or if only members are involved, the Director will consider a variety of factors when determining the hearing location.
- ▶ Deficient claims rules. A deficient claim is a claim that is filed without information or supporting documents required under the new Codes to process the claim. Some reasons a claim may be deficient include a missing or improperly signed Uniform Submission Agreement; a claim that does not specify the current address of the claimant or the claimant's representative; or a claim that does not include all required fees. Rules 12307 and 13307 codify existing practice regarding when a statement of claim may be considered deficient, and the time for correcting any deficiencies.
- ▶ Rules codifying current Initial Prehearing Conference practice (Rules 12500 and 13500).
- ▶ Rules codifying the practice of permitting the attendance of expert witnesses at all hearings (Rules 12602 and 13602).

Rules Implementing Substantive Changes

The new Codes also contain a number of substantive rule changes or new rules intended to streamline and simplify the administration of arbitrations in the NASD forum, or to provide guidance to parties regarding issues not addressed by the old Code. The substantive changes, in the order they appear in the new Codes, are as follows:

Denial of NASD Forum

Under the old Code, the Director of NASD Dispute Resolution (Director) had the authority to deny access to the arbitration forum if the Director determined that the arbitration claim was not a proper subject matter for NASD arbitration. Prior to making this determination, the Director had to seek approval from the National Arbitration and Mediation Committee (NAMC), a balanced committee of public and industry representatives, arbitrators and mediators that advises Dispute Resolution on arbitration rules and procedures.

The new Codes expand the grounds upon which the Director may deny access to the forum and authorize the Director to decline the use of the forum without having to seek prior approval from the NAMC (Rules 12203 and 13203). These rules give the Director more flexibility in addressing security concerns and other unusual, but serious situations that may require immediate resolution.

Amending Pleadings to Add Parties

To begin an arbitration, a claimant must file a statement of claim specifying the relevant facts and remedies requested. The respondent must file an answer specifying the relevant facts and available defenses to the statement of claim. Parties also may file counterclaims, cross claims or third-party claims requiring answers. These documents, taken together, are referred to as pleadings.

Under the old Code, after parties filed a pleading, parties could amend a pleading at any time before an arbitration panel was appointed. Newly added parties could participate in list selection only if they were added before the other parties' arbitrator rankings were consolidated. After the panel was appointed, parties had to obtain approval from the panel to amend a pleading. Thus, under the old Code, a party could amend a pleading to add a party to the proceeding shortly before the panel was appointed, and the newly added party could neither participate in list selection nor object before being added to the arbitration.

To address this issue, the new Codes amend the rules to provide that no party may be added by amendment after ranked lists are due to the Director and before a panel is appointed and approves a request to add the party (Rules 12309 and 13309). The new rules also provide that a party to be added after panel appointment must be given an opportunity to be heard before the panel can grant the motion to amend (Rules 12407 and 13407). This change ensures that a party added to an arbitration by amendment either will be able to participate in list selection, or will be able to object to being added.

Neutral List Selection System Enhancements

From November 1998 until October 2006, the Neutral List Selection System or NLSS was the computer system that generated lists of arbitrators from NASD's rosters of arbitrators for the selected hearing location for each proceeding. After NASD staff sent the list to the parties, the parties selected their panel through a process of striking and ranking the arbitrators on the lists generated by NLSS.

On October 30, 2006, NASD replaced NLSS with a more user-friendly, Web-based application called MATRICS (Mediation and Arbitration Tracking and Retrieval Interactive Case System), which was designed and implemented to support the new Codes. All of the information contained in NLSS has been transferred to MATRICS; it is now the system that governs arbitrator selection in NASD arbitrations. Currently, only NASD staff has access to MATRICS, but NASD is developing additional functionality for MATRICS so that parties and arbitrators can use it as well.⁸

The new Codes contain several modifications to the rules governing arbitrator selection in NASD arbitrations. The new Codes modify list selection by:

- ▶ shifting from a rotational to a random system of generating arbitrator names for the lists sent to parties (Rules 12400(a) and 13400(a));
- ▶ creating a separate list of chair-qualified arbitrators from which the parties will select the chairperson of the panel (Rule 12400(c) and 13400(c)); and
- ▶ expanding the number of names of proposed arbitrators provided to the parties, but limiting the number of arbitrators from each list that each party may strike (Rules 12403, 12404, 13403 and 13404).

Random Selection

Under the old Code, NLSS generated lists of arbitrators from NASD's rosters of arbitrators on a rotational basis. Since the implementation of MATRICS, NASD has been generating lists of arbitrators on a random basis. NASD made the shift from rotational to random selection to assist the programming of MATRICS, and to provide arbitrators with an equal opportunity to be listed on any given list of proposed arbitrators for an arbitration panel.

Chairperson Roster

Under the old Code, NLSS generated two lists of names of proposed arbitrators for three-person, majority-public panels: a list of ten public arbitrators and a list of five non-public arbitrators.⁹ Parties could select their choices by striking arbitrators on the lists whom they did not want on the panel. The parties could strike an unlimited number of arbitrators. After exercising their strikes, the parties ranked the remaining arbitrators, if any, in order of preference and returned their selections to Dispute Resolution. Dispute Resolution consolidated the parties' lists and determined the members of the panel based on the parties' rankings. If insufficient names remained on the list after striking, ranking and consolidation, NLSS generated additional names in the proper category to fill the panel (subject only to challenges for cause). In three-arbitrator cases, the parties then had an opportunity to select a chair from the final list of three arbitrators on the panel. If the parties could not agree on a chair, Dispute Resolution would appoint as the chair the public arbitrator ranked most highly by the parties.¹⁰

The new Codes establish a new roster of chair-qualified arbitrators. Arbitrators are eligible to be placed on the chair roster if they meet certain criteria.¹¹ For a three-person, majority-public panel, parties receive three lists: public chair, public non-chair and non-public. MATRICS generates a list of names from each classification.¹² The parties may strike a limited number of arbitrators from each list, and then must rank the remaining arbitrators in order of preference. Once the parties return the ranked lists, Dispute Resolution consolidates the lists using the rankings of both parties to determine which arbitrator from each classification will be a member of the panel. In a single arbitrator case, we send the parties only the chair list. In intra-industry cases, the Industry Code specifies the panel composition for various types of cases, as described in Rules 13402, 13801, 13802 and 13803.

Striking and Ranking Arbitrators

Under the old Code, after the ranking and striking process concluded, a sufficient number of names might not have remained on the list to fill a three-member panel. When that occurred, the computer generated additional names in the appropriate public or non-public categories and extended the list to fill the panel. Parties were dissatisfied with extended lists because they had no additional strikes to use, and could challenge arbitrators only for cause.

The new Codes modify the rules governing list generation, striking and ranking to increase the number of cases in which the arbitrators on a three-person panel originate from the initial lists sent to parties. Under the new rules, MATRICS selects eight arbitrators for each arbitrator position from the appropriate arbitrator roster (public or non-public chair, public and non-public) to generate the lists parties receive. Each separately represented party may strike up to four of the eight arbitrators on each list for any reason, but must leave at least four names on each list. This change does not eliminate the possibility of computer-generated extended lists, but makes them less likely, thereby providing parties with more control in the arbitrator selection process.

Discovery Rules

Once parties have filed a claim and selected the arbitration panel, they request documents, names of witnesses and other information from each other to prepare their cases for the arbitration hearing. The process of requesting this information is called discovery.

The old Code did not contain detailed provisions relating to the discovery process, but instead relied on the separate Discovery Guide, which was issued as *Notice to Members* 99-90 in 1999. The NASD Discovery Guide provided parties in customer cases with guidance on which documents they should exchange without arbitrator or staff intervention, and provided guidance to arbitrators in determining which documents parties are presumptively required to produce. Perhaps because the provisions of the Discovery Guide were not incorporated into the old Code, parties routinely ignored the discovery guidelines, resulting in significant delays in arbitrations and the frequent need for arbitrator intervention.

To address these concerns and to expedite the discovery process, the new Codes contain many of the Discovery Guide procedures and sanctions. The document lists themselves do not appear in the Customer Code, and the Industry Code does not refer to the document lists since they do not apply to industry disputes.¹³ The new discovery rules give parties more time to respond to document production lists and other requests than under the old Code and Discovery Guide, but also provide more stringent enforcement mechanisms when parties fail to respond, or when parties frivolously object to production of documents or information.

Some of the Discovery Guide provisions that have been incorporated in the new Customer Code are as follows:

Document Production Lists

The Discovery Guide contains lists of documents, called “Document Production Lists,” that are presumed to be discoverable in all arbitrations between a customer and a member or associated person.

Under the old Code, parties had 30 days after the answer was due to provide the relevant documents on the Document Production Lists. If parties failed to comply with this timeframe, the old Code had no rules that specifically addressed non-compliance.

Under the new Customer Code (Rule 12506), parties must produce documents on the relevant Document Production Lists within 60 days from the date that the answer to the statement of claim is due, or explain why production is not possible, or object. NASD also has included a “good faith” standard for compliance in the new rules, so that frivolous delays, unreasonable timeframes or bad-faith objections would be subject to sanctions.

Depositions

A deposition is a discovery practice in which one party (usually through counsel) questions another party or a witness under oath, outside of the hearing process.

The old Code did not contain a provision on depositions that was applicable generally in all arbitration hearings. The old Code did allow depositions in intra-industry arbitrations involving employment discrimination.

The new Codes incorporate the provisions on depositions from the Discovery Guide that strongly discourage depositions in arbitration (Rules 12510 and 13510).

Discovery Sanctions

The old Code did not contain an enforcement mechanism to address non-compliance with the Discovery Guide provisions.

Under the new Codes (Rules 12511 and 13511), the panel may sanction parties who fail to produce documents or object within the relevant time frames. Sanctions may include levying monetary penalties, precluding a party from presenting evidence, making an adverse inference against a party, assessing postponement and forum fees and assessing attorneys' fees and expenses. The panel also may dismiss a claim, defense or arbitration with prejudice for material and intentional failure to comply with an order of the panel if prior warnings or sanctions have proven ineffective.

Exchange of Documents and Witness Lists before a Hearing

Under the old Code, parties were required to provide each other with copies of documents in their possession that they intended to present at the hearing and identify witnesses they intended to present at the hearing. These document exchange procedures often resulted in the exchange of material that had already been provided. This practice delayed hearings and added to the cost of the arbitration without significantly assisting parties in preparing for hearings.

Under the new Codes (Rules 12514 and 13514), parties must exchange only copies of documents that the other parties have not received. This change saves parties time, reduces cost and still ensures that parties exchange documents before a hearing that they intend to use at the hearing. Further, the Codes also strengthen the consequences of non-compliance by prohibiting parties from presenting at the hearing any documents or witnesses that should have been produced before the hearing. The panel, however, may determine that the party had "good cause" for not exchanging the evidence before the hearing and permit the party to present the evidence.

Fees

Users of the old Code frequently complained that the fee schedules were difficult to understand, particularly regarding what parties have to pay when filing an arbitration. The fee schedules contained separate columns for a filing fee and a hearing session deposit, and both fees depended on how much parties claimed as their amounts in dispute. Under the old Code, parties paid a non-refundable filing fee and an initial hearing session deposit to start the arbitration process. Given the numerous fee schedules and related fees and deposits, some parties had trouble figuring out the total amount they had to pay when filing an arbitration claim.

Under the new Codes (Rules 12900 and 13900), the fee schedules are easier to read and understand. First, we combined the filing fee and hearing session deposit into a single fee that a party must pay when filing a claim. If parties settle or withdraw a claim more than 10 days before a hearing, and they owe no other fees or costs, NASD may refund a portion of the filing fee. Second, NASD condensed several sets of fee brackets in the filing fee schedule. The new Codes now contain fewer fee brackets showing how much a party will pay for claims in each bracket. In addition, the new Codes simplify the filing fee schedules without resulting in any significant changes to the amounts parties must pay to file an arbitration claim.

Conclusion

In its approval order, the SEC noted that NASD had expressed its intent to provide staff and arbitrator training on significant changes to the arbitration process made by the new Codes. In the past few months, NASD has conducted several training sessions with staff to prepare for the implementation of the new Codes. NASD also created an online training module that provides an overview of the new Codes and focuses on the changes made to the arbitration process under the new Codes.

The online training module will be made available to arbitrators in the first quarter of 2007. Arbitrators will be required to complete the training on the new Codes in a timely manner. NASD staff also will use the module to continue their training on the new Codes. Other users of the forum will be able to access this online training for a fee.

The SEC suggested that NASD monitor the effectiveness of certain rules, and consider some of the public comments submitted on the new rules in determining whether future amendments are warranted. NASD plans to monitor the effectiveness of the new Codes and, when necessary, to propose amendments to address concerns expressed by users of the forum.

Effective Date Provisions

The Customer and Industry Codes, and the renumbering of the Mediation Code, will become effective on April 16, 2007, and will apply to claims filed on or after the effective date.

In addition, the list selection provisions of the new Codes will apply to previously filed claims in which a list of arbitrators has not yet been generated and sent to the parties, or in which an entirely new list of arbitrators must be generated. In these cases, even though a list has been generated under the new Customer or Industry Code, the claim will continue to be governed by the remaining provisions of the old Code.

Endnotes

- 1 Exchange Act Release No. 55158 (Jan. 24, 2007), 72 FR 4574 (Jan. 31, 2007) (Approval Order for File Nos. SR-NASD-2003-158 and SR-NASD-2004-011).
- 2 Parties in cases filed before the effective date may stipulate in writing to adopt the Customer or Industry Code in its entirety (except for provisions that are moot as a result of the status of the case).
- 3 For example, when a motion for change of venue is granted and a case is moved from one hearing location to another, new lists may be required.
- 4 Chairpersons selected to hear intra-industry claims of statutory employment discrimination must meet the special qualifications of Rule 13802(c) of the Industry Code.
- 5 The SEC approved the Mediation Code on October 31, 2005, and it became effective on January 30, 2006. See Exchange Act Release No. 52705 (Oct. 31, 2005); 70 FR 67525 (Nov. 7, 2005) (File No. SR-NASD-2004-013). The Mediation Code will be amended to renumber the rules, update cross references and insert rule language that had been reserved until the new Codes were approved.
- 6 See Exchange Act Release No. 54360 (August 24, 2006); 71 FR 51879 (August 31, 2006) (File No. SR-NASD-2006-088). NASD is currently reviewing the comments submitted to the SEC on the proposal.
- 7 See Exchange Act Release No. 49688 (May 12, 2004); 69 FR 28966 (May 19, 2004) (File No. SR-NASD-2003-163, approving a rule to permit voluntary direct communication between parties and arbitrators).
- 8 NASD's online arbitration claim filing system is currently the only MATRICS function that parties may access. Parties also have online access to arbitration awards via NASD's Web site.
- 9 Under the new Codes, three-person, majority-public panels are used in customer cases and certain industry cases in which the amount in dispute is \$50,000 or more. For cases involving an amount of more than \$25,000, but not more than \$50,000, a single arbitrator, who will be public in customer cases and in certain industry cases, will hear these cases, unless any party requests a three-person panel in its initial pleading. The new Codes, like the old Code, provide for various types of panel composition in industry cases.
- 10 Staff could not appoint as chair public arbitrators who are attorneys, accountants or other professionals who have devoted 50% or more of their professional or business activities, within the last two years, to representing or advising public customers in matters relating to disputed securities or commodities transactions or similar matters.

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- 11 In order to serve as a chairperson under the new Customer Code, the individual must:
 - 1) be a public arbitrator; 2) have completed chairperson training provided by NASD or have substantially equivalent training or experience; and 3) have a law degree and be a member of a bar of at least one jurisdiction and have served as an arbitrator through award on at least two arbitrations administered by a self-regulatory organization in which hearings were held; or have served as an arbitrator through award on at least three arbitrations administered by a self-regulatory organization in which hearings were held. The new Industry Code contains the same chairperson criteria other than the public arbitrator requirement.
 - 12 Arbitrators who are eligible to serve as chairperson also will be included in the roster of public arbitrators, but will only appear on one list in a particular case.
 - 13 The new Codes do not replace the Discovery Guide entirely. The revised Discovery Guide contains some explanatory provisions and the lists of documents that are presumptively discoverable in customer cases.

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Notice to Members

FEBRUARY 2007

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 January 25, 2007, NASD filed for immediate effectiveness with the Securities and Exchange Commission (SEC) amendments to Rule 2860 extending until September 1, 2007, a pilot program increasing certain stock options position and exercise limits. The pilot program was scheduled to expire on March 1, 2007.

The rules, as amended, are set forth in Attachment A. The amendments become effective March 1, 2007.

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), at (202) 728-8104; or James L. Eastman, Assistant General Counsel, OGC, at (202) 728-6961.

Background and Discussion

On January 25, 2007, NASD filed for immediate effectiveness with the SEC amendments to Rule 2860 extending until September 1, 2007, a pilot program increasing certain stock options position and exercise limits (Pilot Program).¹ The Pilot Program was scheduled to expire on March 1, 2007.² 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 September 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. 55225 (February 1, 2007), 72 FR 6634 (February 12, 2007) (SR-NASD-2007-007).
- 2 See Securities Exchange Act Release No. 54334 (August 18, 2006), 71 FR 50961 (August 28, 2006) (SR-NASD-2006-097) (extending Pilot Program); *NASD Notice to Members 06-46* (August 2006); 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)(VV). A "conventional option" is an option contract not issued, or subject to issuance by, The Options Clearing Corporation. NASD Rule 2860(b)(2)(O). 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 [March 1, 2007]September 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;

(ii) through (viii) No Change.

(B) through (D) No Change.

(4) through (24) No Change.

Notice to Members

FEBRUARY 2007

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Senior Management
Trading

KEY TOPICS

IM-6660-1
OTC Equity Securities
Quotations
Rule 6660
Trading Halts

GUIDANCE

NASD's Trading and Quotation Halt Authority Expanded

SEC Approves Amendments to NASD Rules to Modify and Expand NASD's Authority to Initiate Trading and Quotation Halts in Over-the-Counter (OTC) Equity Securities; **Effective Date: March 16, 2007**

Executive Summary

On December 18, 2006, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 6660 to expand the scope of NASD's authority to initiate trading and quotation halts in OTC Equity Securities and new IM-6660-1 to identify certain factors that NASD may consider in determining, at its discretion, whether imposing a trading and quotation halt in an OTC Equity Security is appropriate.¹

Rule 6660 and IM-6660-1, as approved, are set forth in Attachment A of this *Notice*. The amendments will become effective on March 16, 2007.

Questions/Further Information

Questions or comments regarding this *Notice* may be directed to Elliot Levine, Chief Counsel, Transparency Services, at (202) 728-8405; or Kosha K. Dalal, Associate General Counsel, Office of General Counsel (OGC), at (202) 728-6903.

Operational questions concerning trading and quotation halts in OTC Equity Securities should be directed to NASD Operations at (866) 776-0800, or please refer to the Web site at *OTCBB.com*.

Background and Discussion

Effective October 1, 2005, NASD transferred ownership and operations of the OTC Bulletin Board (OTCBB) from The Nasdaq Stock Market, Inc. (NASDAQ) to NASD. Prompted in part by the transition of the OTCBB, NASD has been analyzing the regulatory framework in this sector of the marketplace to determine whether changes in this area are appropriate. As part of this ongoing effort, NASD is adopting several changes related to its current authority under Rule 6545 to halt trading and quotations in certain OTC Equity Securities.²

Currently, Rule 6545 provides NASD with limited trading and quotation halt authority solely for securities quoted on the OTCBB. Specifically, Rule 6545(a) currently provides NASD with authority to halt trading and quotations of OTCBB securities only where: (1) the OTCBB security (or security underlying an OTCBB American Depository Receipt, otherwise known as an ADR) is listed on or registered with a foreign market and the foreign regulatory authority or market halts trading in the security; (2) the OTCBB security (or the security underlying the OTCBB ADR) is a derivative or component of a security listed on or registered with NASDAQ, a national securities exchange or foreign exchange, and the exchange or market halts trading in the underlying security; or (3) the OTCBB issuer fails to comply with the requirements of SEC Rule 10b-17, which generally requires the issuer of a class of securities that are publicly traded to give notice to NASD no later than 10 days prior to the record date of a dividend or distribution. Pursuant to Rule 6545, NASD has authority to halt trading and quotations of securities quoted on the OTCBB for up to five business days.

On December 18, 2006, the SEC approved amendments to expand the scope of NASD's authority to initiate trading and quotation halts in OTC Equity Securities.³ Specifically, Rule 6545, as amended and renumbered to Rule 6660,⁴ expands the scope of NASD authority to initiate trading and quotation halts in all OTC Equity Securities, which includes ADRs that trade in the OTC market, securities quoted in quotation mediums other than the OTCBB (e.g., the Pink Sheets), and other OTC Equity Securities. This expansion will allow NASD to impose its trading and quotation halt authority uniformly to all OTC Equity Securities eliminating the disparity between OTCBB securities and other quotation mediums.

Further, Rule 6660 expands NASD's existing trading halt authority to provide more general trading and quotation halt authority beyond halts related to non-compliance with SEC Rule 10b-17, while limiting such authority to only those extraordinary events that have a material effect on the market for the OTC Equity Security and have the potential to cause major disruption to the marketplace and/or significant uncertainty in the settlement and clearance process. Specifically, under Rule 6660(a)(3), NASD has the authority to impose a trading and quotation halt for material events, where NASD determines, at its discretion, based on the facts and circumstances of the particular event, that halting trading in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace.

In addition, Rule 6660 increases the maximum number of business days that NASD can impose a trading and quotation halt from up to five business days to 10 business days. A halt for a period of up to 10 business days is consistent with the SEC's authority to temporarily suspend trading in securities in accordance with Section 12(k) of the Exchange Act. Increasing the maximum number of days from five to 10 business days will allow more time for regulators to act and for the market of the subject security to stabilize.

NASD is also adopting IM-6660-1 to identify certain factors that NASD may consider in determining, at its discretion, whether halting trading in an OTC Equity Security under Rule 6660(a)(3) is appropriate. Due to the general nature of quoting and trading in the OTC Equity market, and the fact that NASD lacks a direct contractual relationship with OTC Equity issuers, NASD does not favor imposing a trading halt and thus expects to exercise this authority in very limited circumstances. Specifically, IM-6660-1 provides that NASD will consider several factors in making its determination, including but not limited to: (1) the material nature of the event; (2) the material facts surrounding the event are undisputed and not in conflict; (3) the event has caused widespread confusion in the trading of the security; (4) there has been a material negative effect on the market for the subject security; (5) the potential exists for a major disruption to the marketplace; (6) there is significant uncertainty in the settlement and clearance process for the security; and/or (7) such other factors as NASD deems relevant in making its determination. NASD may review all or some of these factors as it determines appropriate. NASD staff will weigh the relevant information and make a determination whether halting trading in the security is appropriate and may consult with NASD's Uniform Practice Code Committee (or any successor thereto) as it deems necessary or appropriate.

Based on NASD's experience to date, each event presents a unique set of facts and circumstances. As a result, NASD expects to exercise significant discretion in determining whether a particular event affecting a security warrants a trading and quotation halt. Notably, Rule 6660 will not be used in cases solely where NASD suspects that corporate fraud or manipulative activity is occurring with respect to a security, because NASD does not believe this authority is the appropriate tool for addressing allegations of fraud. Nor will the authority be used to correct informational imbalances resulting from corporate news about the issuer—*e.g.*, financial results, release of new product, or pending regulatory investigation—because NASD has no listing or other agreement with the issuer of an OTC Equity Security and therefore cannot compel such issuers to disclose material information.

Impact of Trading and Quotation Halt on SEC Rule 15c2-11, NASD 6640 and Form 211

It is important to note that for OTC Equity Securities, in certain instances, quoting will not automatically resume when a trading halt ends. If trading is halted for four or more business days, quoting cannot resume for OTC Equity Securities until broker-dealers comply with the requirements of SEC Rule 15c2-11 and NASD Rule 6640. Such rules require a broker-dealer to review information about the issuer and have a reasonable basis under the circumstances to believe that the issuer information is accurate in all material respects and the sources of such information are reliable. As a result, any trading and quotation halt greater than four business days generally would require broker-dealers to comply with the requirements of NASD Rule 6640 before resuming publication of quotations on the subject security.

Operational Matters

Publication of Trading and Quotation Halts

NASD expects that announcements regarding trading and quotation halts will continue to be disseminated/published as they currently are for OTCBB securities, including through NASDAQ MarketWatch and *OTCBB.com*.

Foreign Regulatory Halts

With respect to trading and quotation halts under Rule 6660(a)(1) for foreign regulatory halts, information is received only from certain foreign markets, given that foreign markets generally have no obligation to provide halt information to NASD. As a result, the current ability to halt trading and quotations in a security pursuant to Rule 6660(a)(1) is limited. Thus, *OTCBB.com* currently posts and will continue to post the following message: "Non-US exchanges, markets and regulatory authorities are under no obligation to report halts or other information pertaining to securities in their markets to NASD or NASDAQ."

Domestic Halts

With respect to trading and quotation halts under Rule 6660(a)(2) for derivatives or components of exchange-listed securities, efforts will be made to coordinate with domestic markets to receive information regarding trading and quotation halts. If there are OTCBB or other OTC listings that are derivatives or components of the security halted on an exchange, generally a corresponding halt for such securities will be implemented.

New Halt Codes/Security Category

NASD is developing new halt codes and descriptions to correspond to Rule 6660. NASD anticipates that the new codes and descriptions will be implemented by the end of April 2007.

NASD will announce the new halt codes and descriptions in a future *Notice to Members*.

Endnotes

- 1 See Exchange Act Release No. 54952 (December 18, 2006), 71 FR 78242 (December 28, 2006) (File No. SR-NASD-2006-039).
- 2 The term "OTC Equity Security" is defined in Rule 6610(d) to mean "any non-exchange listed security and certain exchange-listed securities that do not otherwise qualify for real-time trade reporting." Certain securities may not qualify for real-time reporting because they are not "eligible securities" as defined in Rule 6410(d). The term "OTC Equity Security" does not include "restricted securities," as defined by Rule 144(a)(3) under the Securities Act of 1933, nor any securities designated in the PORTAL Market under the NASD Rule 5300 Series.
- 3 See *supra* note 1.
- 4 Because the current NASD Rule 6500 Series relates solely to OTCBB securities, NASD has renumbered Rule 6545 as Rule 6660, which will become part of the NASD rules relating to OTC Equity Securities.

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ATTACHMENT A

New language is underlined. Deleted language is in brackets.

* * * * *

[6545]6660. Trading and Quotation Halt in OTC[BB-Eligible] Equity Securities

(a) Authority for Initiating a Trading and Quotation Halt

In circumstances in which it is necessary to protect investors and the public interest, NASD may direct members, pursuant to the procedures set forth in paragraph (b), to halt trading and quotations in OTC Equity Securities (as such term is defined in Rule 6610) [the over-the-counter (“OTC”) market of a security or an American Depository Receipt (“ADR”), that is included in the OTC Bulletin Board (“OTCBB”)] if:

(1) the OTC[BB] Equity S[s]ecurity or the security underlying an American Depository Receipt (“ADR”) that is an OTC Equity Security (“OTC ADR”)[the OTCBB ADR] is listed on or registered with a foreign securities exchange or market, and the foreign securities exchange, market, or regulatory authority overseeing such issuer, exchange, or market, halts trading in such security for regulatory reasons because of public interest concerns (“Foreign Regulatory Halt”); provided, however, that NASD will not impose a trading and quotation halt if the Foreign Regulatory Halt was imposed solely for material news, a regulatory filing deficiency, or operational reasons; [or]

(2) the OTC[BB] Equity S[s]ecurity or the security underlying [the]an OTC[BB] ADR is a derivative or component of a security listed on or registered with a national securities exchange or foreign securities exchange or market (“listed security”), and the national securities exchange, or foreign securities exchange or market imposes a trading halt in the listed security[.]; or

(3) NASD determines that an extraordinary event has occurred or is ongoing that has had a material effect on the market for the OTC Equity Security or has caused or has the potential to cause major disruption to the marketplace and/or significant uncertainty in the settlement and clearance process. [the issuer of the OTCBB security or the security underlying the OTCBB ADR fails to comply with the requirements of SEC Rule 10b-17 regarding Untimely Announcements of Record Dates.]

(b) Procedure for Initiating a Trading and Quotation Halt

(1) When a halt is initiated under subparagraph (a)(1) of this rule, upon receipt of information from a foreign securities exchange or market on which the OTC[BB] Equity S[s]ecurity or the security underlying the OTC[BB] ADR is listed or registered, or from a regulatory authority overseeing such issuer, exchange, or market, NASD will promptly evaluate the information and determine whether a trading and quotation halt in the OTC[BB] Equity S[s]ecurity is appropriate.

(2) Should NASD determine that a basis exists under this rule for initiating a trading and quotation halt, the commencement of the trading and quotation halt will be effective simultaneous with the issuance of appropriate public notice.

(3) Trading and quotations in the OTC market may resume when NASD determines that the basis for the halt no longer exists, or when [five]10 business days have elapsed from the date NASD initiated the trading and quotation halt in the security, whichever occurs first. NASD shall disseminate appropriate public notice that the trading and quotation halt is no longer in effect.

(c) Violation of OTC[BB] Trading and Quotation Halt Rule

If a security is subject to a trading and quotation halt initiated pursuant to this rule, it shall be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 2110 for a member:

(1) to effect, directly or indirectly, a trade in such security; or

(2) to publish a quotation, a priced bid and/or offer, an unpriced indication of interest (including "bid wanted" and "offer wanted" indications), or a bid or offer accompanied by a modifier to reflect unsolicited customer interest, in any quotation medium. For purposes of this rule, "quotation medium" shall mean any: system of general circulation to brokers or dealers that regularly disseminates quotations of identified brokers or dealers; or publication, alternative trading system or other device that is used by brokers or dealers to disseminate quotations to others.

* * * * *

IM-6660-1 Factors to be Considered When Initiating a Trading and Quotation Halt

NASD may impose a trading and quotation halt in an OTC Equity Security pursuant to Rule 6660(a)(3) where NASD determines, in its discretion, based on the facts and circumstances of the particular event, that halting trading in the security is the appropriate mechanism to protect investors and ensure a fair and orderly marketplace. As a general matter, NASD does not favor imposing a trading and quotation halt in an OTC Equity Security and will exercise this authority in very limited circumstances. In determining whether to impose a trading halt under Rule 6660(a)(3), NASD will consider several factors in making its determination, including but not limited to: (1) the material nature of the event; (2) the material facts surrounding the event are undisputed and not in conflict; (3) the event has caused widespread confusion in the trading of the security; (4) there has been a material negative effect on the market for the subject security; (5) the potential exists for a major disruption to the marketplace; (6) there is significant uncertainty in the settlement and clearance process for the security; and/or (7) such other factors as NASD deems relevant in making its determination. NASD may review all or some of these factors as it determines appropriate.

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Notice to Members

FEBRUARY 2007

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Registration
Senior Management
Training

KEY TOPICS

BrokerCheck
Form BD (Uniform Application for Broker-Dealer Registration)
Form BDW (Uniform Application for Broker-Dealer Withdrawal)
Form U4 (Uniform Application for Securities Industry Registration or Transfer)
Form U5 (Uniform Termination Notice for Securities Industry Registration)
Form U6
IM-8310-2
IM-8310-3

GUIDANCE

NASD BrokerCheck

SEC Approves Changes to NASD Interpretive Material 8310-2 Regarding the Release of Information through NASD BrokerCheck; **Effective Date: March 19, 2007**

Executive Summary

The Securities and Exchange Commission (SEC) has approved amendments to Interpretive Material 8310-2 (IM-8310-2), governing the release of information through NASD BrokerCheck (formerly known as NASD's Public Disclosure Program).¹ These amendments expand the information NASD makes available through BrokerCheck and reflect NASD's commitment to strike a fair balance between investor protection and the privacy interests of member firms and their associated persons. Additionally, NASD is making BrokerCheck more user-friendly and improving its security and integrity by replacing the current method for the electronic delivery of BrokerCheck reports and by introducing a redesigned BrokerCheck Web site. NASD is also introducing an educational component of the BrokerCheck report and Web site that it believes will enable the reader to view disclosure events in the appropriate context and give appropriate weight to all disclosure events when evaluating a particular firm or broker. Upon request, subject to terms and conditions established by NASD and after execution of a licensing agreement prepared by NASD, NASD will also provide a compilation of selected data of NASD members. The amendments to IM-8310-2 and changes to NASD BrokerCheck are effective March 19, 2007. The amended text of IM-8310-2 and IM-8310-3 is attached to this *Notice* in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to Richard E. Pullano, Chief Counsel and Associate Vice President, Registration and Disclosure, at (240) 386-4821; or Stefanie M. Watkins, Senior Counsel, Registration and Disclosure, at (240) 386-4824.

Background

NASD established its public disclosure program (now known as BrokerCheck) in 1988 to provide the public with information on the professional background, business practices and conduct of NASD member firms and their associated persons. In 1990, with NASD's support, Congress passed legislation requiring NASD to establish and maintain a toll-free telephone number to respond to inquiries about member firms and associated persons. In 1998, NASD began providing certain administrative information, such as registration and employment history, online via NASD's Web site (www.nasd.com). In 2000, NASD established a two-year period for disclosure of information about persons formerly registered with an NASD member, increased the amount of information disclosed to investors through BrokerCheck and refined the report delivery process.

BrokerCheck currently processes over four million inquiries each year and gives investors an opportunity to obtain information essential to making an informed choice on whether to do business with a particular broker or securities firm. The changes to BrokerCheck, as described in this *Notice*, are the product of a comprehensive review of the information available through BrokerCheck and the way in which it is delivered to the public.

Information NASD Will Release through BrokerCheck

Subject to the exceptions described below, NASD will release through BrokerCheck the following information regarding current or former members, persons currently registered with an NASD member, or persons who were registered with an NASD member within the preceding two years, as reported on the most recently filed Form U4, Form U5, Form U6 (the form used by regulators to report actions), Form BD and Form BDW (collectively, Registration Forms).

NASD will release:

- ◆ Currently approved registrations for brokers and member firms.
- ◆ Information about qualifications examinations passed by the broker and date passed.
- ◆ The name and succession history for current or former member firms.
- ◆ Summary information about certain arbitration awards against a member firm involving a securities or commodities dispute with a public customer.
- ◆ Information regarding control relationships, direct and indirect owners, and executive officers as provided on the Form BD.
- ◆ Information regarding the date of withdrawal from NASD registration and, if appropriate, details regarding funds owed customers or other firms, as provided on the Form BDW.
- ◆ In response to telephonic inquiries via the BrokerCheck toll-free telephone listing, whether a particular member firm is subject to the provisions of the Taping Rule (NASD Rule 3010(b)(2)).

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- ▶ Historic Complaints (*i.e.*, the information last reported on Registration Forms relating to customer complaints that are more than two (2) years old and that have not been settled or adjudicated, and customer complaints, arbitrations or litigations that have been settled for an amount less than \$10,000 and are no longer reported on a Registration Form), **provided that**:
 - (1) any such matter became a Historic Complaint on or after March 19, 2007;
 - (2) the most recent Historic Complaint or currently reported customer complaint, arbitration or litigation is less than ten (10) years old; and
 - (3) the person has a total of three (3) or more currently disclosable regulatory actions, currently reported customer complaints, arbitrations or litigations, or Historic Complaints (subject to the limitation that they became a Historic Complaint on or after March 19, 2007), or any combination thereof.

In other words, only those disclosure events (*i.e.*, customer complaints, arbitrations or litigations) that were archived on or after March 19, 2007 will be considered Historic Complaints for purposes of determining whether a person's Historic Complaints become eligible for disclosure through BrokerCheck.

- ▶ Broker Comments. As described below, currently registered persons and persons who are not currently registered with a member firm, but who were registered with an NASD member within the last two years (and who are, therefore, subject to BrokerCheck)² will be given an opportunity to add context to or update information that may be disclosed through BrokerCheck.

Persons No Longer Registered with a Member Firm May Submit Broker Comments

Starting on March 19, 2007, NASD will give persons who are not currently registered with an NASD member, but who were registered within the last two years, an opportunity to submit a comment through the Broker Comment process. (As explained below, the Broker Comment process will not be available to currently registered persons.) Persons wishing to submit a Broker Comment must complete a *Broker Comment Request Form*, which may be found on NASD's Web site. The *Request Form* must be signed and notarized. NASD will also post *Guidelines for Broker Comments on BrokerCheck* on its Web site. NASD will review all submitted Request Forms to confirm relevance and compliance with the established instructions. Only Broker Comments that relate to the information provided through BrokerCheck will be accepted. If the person's Broker Comment meets NASD's criteria, NASD will add the Comment to the written report provided through BrokerCheck. The person submitting the Comment will be able to amend, replace or delete the Comment in the same way. These Comments will also be made available through the Central Registration Depository (CRD[®]) to participating regulators, and to any member firms with which the person who submitted the Comment seeks to be associated subject to the pre-registration protocols,³ so long as the person is subject to BrokerCheck.

Registered Persons Continue to Provide Comments on Form U4

Persons who are currently registered with a member firm will continue to have the opportunity to provide details in the appropriate Disclosure Reporting Page (DRP) of the Form U4. Currently, registered persons may provide details at the time a disclosure event is reported. Additionally, if the registered person wishes to add to his or her previously submitted filing, or provide comments for the first time, the person may, through his or her firm, amend the Form U4 to provide an additional statement relating to the reportable event.

NASD will not edit these comments (whether submitted via Form U4 or a Broker Comment Form); however, consistent with current practice, NASD reserves the right to reject comments or redact information from comments, on a case-by-case basis, that contain confidential customer information, offensive or potentially defamatory language, or information that raises significant identity theft, personal safety or privacy concerns that are not outweighed by investor protection concerns. NASD will post *Guidelines for Broker Comments on BrokerCheck* on NASD's Web site.

Additionally, NASD reminds all registered persons and persons registered within the last two years that customer complaints that become non-reportable may, at some future time, be eligible for disclosure through BrokerCheck. Therefore, all persons who are subject to BrokerCheck (whether registered or formerly registered) are responsible for ensuring that their comments about any customer complaint adequately reflect their views and concerns, in the event that the matter, although not currently disclosed through BrokerCheck, may be disclosed in the future as a Historic Complaint.

Information NASD Will Not Release through BrokerCheck

NASD will not release:

- ▶ Social Security numbers, residential history information, physical description information, information that NASD is otherwise prohibited from releasing under Federal law or information that is provided solely for use by regulators.
- ▶ Information about current or former members, registered persons or persons who were registered with an NASD member within the preceding two years that has been reported on registration forms relating to regulatory investigations or proceedings if the reported regulatory investigation or proceeding was vacated or withdrawn by the instituting authority.
- ▶ "Internal Review Disclosure" information reported by members, associated persons or regulators on Section 7 of the Form U5.⁴
- ▶ "Reason for Termination" information reported on Section 3 of the Form U5.

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- ▶ Form U5 disclosure information for fifteen (15) days following the filing of such information. This will give persons on whose behalf the Form U5 was submitted an opportunity to file (or amend) a Form U4 or submit a separate Broker Comment to NASD for inclusion with the information released pursuant to BrokerCheck, regarding disclosure information reported on the Form U5 and any amendments thereto. NASD would then release both the Form U5 disclosure information and the person's comment, if any, to a requester.
 - ▶ The most recent information reported on a Registration Form if:
 - (1) NASD has determined that the information was reported in error by a firm, regulator or other appropriate authority; or
 - (2) the information has been determined by regulators, through amendments to the Registration Forms, to be no longer relevant to securities registration or licensure, regardless of the disposition of the event or the date the event occurred.
 - ▶ Information regarding branch offices provided on Schedule E of the Form BD.⁵

In addition, NASD reserves the right to exclude, on a case-by-case basis, information that contains confidential customer information, offensive or potentially defamatory language, or information that raises significant identity theft, personal safety or privacy concerns that are not outweighed by investor protection concerns.

Educational Component of BrokerCheck

NASD has also developed an educational component of the BrokerCheck report and the BrokerCheck Web site that it believes will help the reader to view disclosure events in the appropriate context and give appropriate weight to all disclosure events when evaluating a particular firm or broker. These online educational materials consist of text and links to other resources and are designed to help the users of BrokerCheck better understand the content, context and source of the information provided through BrokerCheck and help investors in choosing a broker or firm.

An introductory section immediately preceding the BrokerCheck report will explain that some reported items may involve pending actions or allegations that may be contested and have not been resolved or proven, and that these items may be withdrawn or dismissed, resolved in favor of the broker or concluded through a negotiated settlement with no admission or conclusion of wrongdoing. The report will also include certain status information on each type of disclosure event (provided the firm and/or regulator has reported the disposition on a Registration Form), so that the reader will know whether the complaint was resolved and, if so, how it was resolved. In addition, both the BrokerCheck report and the BrokerCheck Web site will advise the reader not to rely solely on the information available through the BrokerCheck program, but to learn as much as possible about the broker or firm from other sources.⁶

Electronic Delivery of BrokerCheck Reports

Prior to March 19, 2007, NASD delivered BrokerCheck reports via U.S. mail (when requested through NASD's toll-free number) or email (when requested online via BrokerCheck). NASD will continue to deliver BrokerCheck reports via U.S. mail, but will no longer send reports as file attachments in an email. Due to a number of practical issues that have arisen regarding email delivery, NASD will replace the current delivery approach with access to an online report through a secure Internet session in response to inquiries via its Web site or through the established toll-free number. The report will be in Portable Document Format (PDF) and will be viewable online within seconds after a request is made. This improved delivery method will result in more efficient and faster delivery of reports and will eliminate previous email file size limitations often encountered by users under the previous delivery methods. A requester also will be able to view investor education materials that will aid him or her in understanding the written report. NASD will continue to provide hard copy reports to those requesting hard copies.

Compilation of Information

Starting on March 19, 2007, upon written request, NASD will provide to the public (subject to terms and conditions established by NASD, and after execution of a licensing agreement prepared by NASD) a compilation of information selected by NASD from the Forms BD and BDW. The information provided under the licensing agreement will be limited to information that is otherwise publicly available from the SEC. NASD expects to charge a fee to commercial users. Interested persons should call the BrokerCheck Hotline ((800) 289-9999) for information on how to obtain a compilation.

Endnotes

- 1 Securities Exchange Act Release No. 55127 (January 18, 2007), 72 FR 3455 (January 25, 2007) (SR-NASD-2003-168). These amendments also created IM-8310-3, which was formerly denominated as IM-8310-2(b). IM-8310-3 contains the rules regarding the release of disciplinary complaints, decisions and other information.
- 2 Requesters may obtain information about brokers through BrokerCheck only during the time such persons are registered with NASD and for two years following the termination of their registration with an NASD member firm.
- 3 NASD member firms are required to obtain an individual's written consent prior to reviewing his or her CRD record in connection with a firm's consideration of a potential employee.
- 4 NASD will not release the response to the internal review question and related information reported on the associated DRP through BrokerCheck. However, if the matter that was the subject of the internal review is or becomes reportable under the investigation, termination or other disclosure questions, the disclosure information made pursuant to these other disclosure questions would be released.
- 5 Branch office information formerly reported on Schedule E of the Form BD is now reported on the Form BR (Uniform Branch Office Registration Form).
- 6 For example, NASD suggests that investors contact state securities regulators, local consumer and investment groups, or others who have established business relationships with a particular broker or firm.

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ATTACHMENT A

Proposed new language is underlined; proposed deletions are in brackets.

* * * * *

IM-8310-2. [Release of Disciplinary and Other Information Through the Public Disclosure Program] NASD BrokerCheck Disclosure

(a) In response to a written inquiry, electronic inquiry, or telephonic inquiry via a toll-free telephone listing, [the Association] NASD shall release certain information [contained in the Central Registration Depository] regarding a current or former member, an associated person, or a person who was associated with a member within the preceding two years, through [the Public Disclosure Program] NASD BrokerCheck. [Such information shall include:]

[(1) the person's employment history and other business experience required to be reported on Form U-4;]

[(2) currently approved registrations for the member or associated person;]

[(3) the main office, legal status, and type of business engaged in by the member; and]

[(4) an event or proceeding-]

[(A) required to be reported under Item 14 on Form U-4;]

[(B) required to be reported under Item 11 on Form BD; or]

[(C) reported on Form U-6.]

[The Association also shall make available through the Public Disclosure Program certain arbitration decisions against a member involving a securities or commodities dispute with a public customer. In addition, the Association shall make available in response to telephonic inquiries via the Public Disclosure Program's toll-free telephone listing whether a particular member is subject to the provisions of Rule 3010(b)(2). The Association shall not release through the Public Disclosure Program social security numbers, residential history information, or physical description information, or information that the Association is otherwise prohibited from releasing under Federal law.]

(b) Except as otherwise provided in paragraph (c) below, NASD shall release:

(1) any information reported on the most recently filed Form U4, Form U5, Form U6, Form BD, and Form BDW (collectively "Registration Forms");

(2) currently approved registrations;

(3) summary information about certain arbitration awards against a member involving a securities or commodities dispute with a public customer;

(4) the most recently submitted comment, if any, provided to NASD by the person who is covered by BrokerCheck, in the form and in accordance with the procedures established by NASD, for inclusion with the information provided through BrokerCheck. Only comments that relate to the information provided through BrokerCheck will be included;

(5) information as to qualifications examinations passed by the person and date passed. NASD will not release information regarding examination scores or failed examinations;

(6) in response to telephonic inquiries via the BrokerCheck toll-free telephone listing whether a particular member is subject to the provisions of Rule 3010(b)(2) ("Taping Rule");

(7) Historic Complaints (i.e., the information last reported on Registration Forms relating to customer complaints that are more than two (2) years old and that have not been settled or adjudicated, and customer complaints, arbitrations or litigations that have been settled for an amount less than \$10,000 and are no longer reported on a Registration Form), provided that:

(A) any such matter became a Historic Complaint on or after March 19, 2007;

(B) the most recent Historic Complaint or currently reported customer complaint, arbitration or litigation is less than ten (10) years old; and

(C) the person has a total of three (3) or more currently disclosable regulatory actions, currently reported customer complaints, arbitrations or litigations, or Historic Complaints (subject to the limitation that they became a Historic Complaint on or after March 19, 2007), or any combination thereof; and

(8) the name and succession history for current or former members.

(c) NASD shall not release:

(1) information reported as a Social Security number, residential history or physical description, information that NASD is otherwise prohibited from releasing under Federal law, or information that is provided solely for use by regulators. NASD reserves the right to exclude, on a case-by-case basis, information that contains confidential customer information, offensive or potentially defamatory language or information that raises significant identity theft, personal safety or privacy concerns that are not outweighed by investor protection concerns;

(2) information reported on Registration Forms relating to regulatory investigations or proceedings if the reported regulatory investigation or proceeding was vacated or withdrawn by the instituting authority;

(3) "Internal Review Disclosure" information reported on Section 7 of the Form U5;

(4) "Reason for Termination" information reported on Section 3 of the Form U5;

(5) Form U5 information for fifteen (15) days following the filing of such information;

(6) the most recent information reported on a Registration Form, if:

(A) NASD has determined that the information was reported in error by a member, regulator or other appropriate authority;

(B) the information has been determined by regulators, through amendments to the uniform Registration Forms, to be no longer relevant to securities registration or licensure, regardless of the disposition of the event or the date the event occurred;

(7) information provided on Schedule E of Form BD.

(d) Upon written request, NASD may provide a compilation of information about NASD members, subject to terms and conditions established by NASD and after execution of a licensing agreement prepared by NASD. NASD may charge commercial users of such information reasonable fees as determined by NASD. Such compilations shall consist solely of information selected by NASD from Forms BD and BDW and shall be limited to information that is otherwise publicly available from the Commission.

IM-8310-3 Release of Disciplinary Complaints, Decisions and Other Information

[(b)](a) [The Association] NASD shall, in response to a request, release to the requesting party a copy of any identified disciplinary complaint or disciplinary decision issued by [the Association] NASD or any subsidiary or Committee thereof; provided, however, that each copy of:

(1) a disciplinary complaint shall be accompanied by the following statement: "The issuance of a disciplinary complaint represents the initiation of a formal proceeding by [the Association] NASD in which findings as to the allegations in the complaint have not been made and does not represent a decision as to any of the allegations contained in the complaint. Because this complaint is unadjudicated, you may wish to contact the respondent before drawing any conclusions regarding the allegations in the complaint."

(2) a disciplinary decision that is released prior to the expiration of the time period provided under the Rule 9000 Series for appeal or call for review within [the Association] NASD or while such an appeal or call for review is pending, shall be accompanied by a statement that the findings and sanctions imposed in the decision may be increased, decreased, modified, or reversed by [the Association] NASD;

(3) a final decision of [the Association] NASD that is released prior to the time period provided under the Act for appeal to the Commission or while such an appeal is pending, shall be accompanied by a statement that the findings and sanctions of [the Association] NASD are subject to review and modification by the Commission; and

(4) a final decision of [the Association] NASD that is released after the decision is appealed to the Commission shall be accompanied by a statement as to whether the effectiveness of the sanctions has been stayed pending the outcome of proceedings before the Commission.

[(c)](b)(1) [The Association] NASD shall release to the public information with respect to any disciplinary complaint initiated by the Department of Enforcement or the Department of Market Regulation of NASD [Regulation, Inc.], the NASD Regulation, Inc. Board of Directors, or the NASD Board of Governors containing an allegation of a violation of a designated statute, rule or regulation of the Commission, NASD, or Municipal Securities Rulemaking Board, as determined by the NASD Regulation, Inc. Board of Directors (a "Designated Rule"); and may also release such information with respect to any disciplinary complaint or group of disciplinary complaints that involve a significant policy or enforcement determination where the release of information is deemed by the President of NASD [Regulation, Inc.] Regulatory Policy and Oversight to be in the public interest.

(2) Information released to the public pursuant to [sub]paragraph [(c)](b)(1) shall be accompanied by the statement required under [sub]paragraph [(b)](a)(1).

[(d)](c)(1) NASD shall release to the public information with respect to any disciplinary decision issued pursuant to the Rule 9000 Series imposing a suspension, cancellation or expulsion of a member; or suspension or revocation of the registration of a person associated with a member; or suspension or barring of a member or person associated with a member from association with all members; or imposition of monetary sanctions of \$10,000 or more upon a member or person associated with a member; or containing an allegation of a violation of a Designated Rule; and may also release such information with respect to any disciplinary decision or group of decisions that involve a significant policy or enforcement determination where the release of information is deemed by the President of NASD Regulatory Policy and Oversight to be in the public interest. NASD also may release to the public information with respect to any decision issued pursuant to the Rule 9550 Series imposing a suspension or cancellation of the member or a suspension or bar of the association of a person with a member, unless NASD determines otherwise. NASD may, in its discretion, determine to waive the requirement to release information with respect to a disciplinary or other decision under those extraordinary circumstances where the release of such information would violate fundamental notions of fairness or work an injustice. NASD also shall release to the public information with respect to any temporary cease and desist order issued pursuant to the Rule 9800 Series. NASD may release to the public information on any disciplinary or other decision issued pursuant to the Rule 9000 Series, not specifically enumerated in this paragraph, regardless of sanctions imposed, so long as the names of the parties and other identifying information is redacted.

(A) NASD shall release to the public, in unredacted form, information with respect to any disciplinary decision issued pursuant to the Rule 9300 Series that does not meet one or more of the criteria in [IM-8310-2(d)(1)] IM-8310-3(c)(1) for the release of information to the public, provided that the underlying decision issued pursuant to the Rule 9200 Series meets one or more of the criteria in [IM-8310-2(d)(1)] IM-8310-3(c)(1) for the release of information to the public, and information regarding such decision has been released to the public in unredacted form.

(B) In the event there is more than one respondent in a disciplinary decision issued pursuant to the Rule 9000 Series, and sanctions imposed on one or more, but not all, of the respondents meets one or more of the criteria in [Rule IM-8310-2(d)(1)] IM-8310-3(c)(1) for the release of information to the public, NASD shall release to the public, in unredacted form, information with respect to the respondent(s) who meet such criteria, and may release to the public, in redacted form, information with respect to the respondent(s) who do not meet such criteria. Notwithstanding the foregoing, NASD shall release to the public, in unredacted form, information with respect to any respondent in a disciplinary decision issued pursuant to the Rule 9300 Series if the sanctions imposed on such respondent in the underlying decision issued pursuant to the Rule 9200 Series meet one or more of the criteria for release of information to the public, and information with respect to that respondent has been released in unredacted form.

(2) Information released to the public pursuant to [sub]paragraph [(d)](c)(1) shall be accompanied by a statement to the extent required for that type of information under [sub]paragraphs [(b)](a)(2)-(4).

[(e)](d) If a decision issued pursuant to the Rule 9000 Series other than by the National Adjudicatory Council is not appealed to or called for review by the National Adjudicatory Council, the decision shall become effective on a date set by [the Association] NASD but not before the expiration of 45 days after the date of decision.

[(f)](e) Notwithstanding paragraph [(e)](d), expulsions and bars imposed pursuant to the provisions of Rules 9216 and 9270 shall become effective upon approval or acceptance by the National Adjudicatory Council, and information regarding any sanctions imposed pursuant to those Rules may be released to the public pursuant to paragraph [(d)](c) immediately upon such approval or acceptance.

[(g)](f) No change in text.

[(h)](g) If a decision of [the Association] NASD imposing monetary sanctions of \$10,000 or more or a penalty of expulsion, revocation, suspension and/or barring of a member from being associated with all members is appealed to the Commission, notice thereof shall be given to the membership and to the press as soon as possible after receipt by [the Association] NASD of notice from the Commission of such appeal and [the Association's] NASD's notice shall state whether the effectiveness of the Board's decision has been stayed pending the outcome of proceedings before the Commission.

[(i)](h) In the event an appeal to the courts is filed from a decision by the Commission in a case previously appealed to it from a decision of [the Association] NASD, involving the imposition of monetary sanctions of \$10,000 or more or a penalty of expulsion, revocation, suspension and/or barring of a member from being associated with all members, notice thereof shall be given to the membership as soon as possible after receipt by [the Association] NASD of a formal notice of appeal. Such notice shall include a statement whether the order of the Commission has been stayed.

[(j)](i) Any order issued by the Commission of revocation or suspension of a member's broker/dealer registration with the Commission; or the suspension or expulsion of a member from [the Association] NASD; or the suspension or barring of a member or person associated with a member from association with all broker/dealers or membership; or the imposition of monetary sanctions of \$10,000 or more shall be released to the public through a notice containing the effective date thereof sent as soon as possible after receipt by [the Association] NASD of the order of the Commission.

[(k)](j) Cancellations of membership or registration pursuant to [the Association's] NASD's By-Laws, Rules and Interpretative Material shall be released to the public as soon after the effective date of the cancellation as possible.

[(l)](k) Releases to the public referred to in paragraphs [(c)](b) and [(d)](c) above shall identify the NASD Rules and By-Laws [of the Association] or the SEC Rules violated, and shall describe the conduct constituting such violation. Releases may also identify the member with which an individual was associated at the time the violations occurred if such identification is determined by [the Association] NASD to be in the public interest.

[(m)](l) No change in text.

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Notice to Members

FEBRUARY 2007

SUGGESTED ROUTING

Legal and Compliance
Margin
Operations
Senior Management

KEY TOPICS

Margin Requirements
Portfolio Margin
Rule 2520
Rule 2860

GUIDANCE

Portfolio Margin Program

Amendment to Margin Rules to Establish a Portfolio Margin Pilot Program; **Effective Date: April 2, 2007**

Executive Summary

On February 12, 2007, NASD filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a rule change to amend Rule 2520 to permit members to margin certain products according to a prescribed portfolio margin methodology on a pilot basis. NASD also amended Rule 2860 to require that a disclosure statement and written acknowledgement for use with the proposed portfolio margin program be furnished to customers using a portfolio margin account.¹

Rules 2520 and 2860, as amended, are set forth in Attachment A of this *Notice*. The portfolio margin program will operate on a pilot basis starting on April 2, 2007, and ending July 31, 2007, unless the SEC approves an extension of the pilot or adoption of the program on a permanent basis.

Questions/Further Information

Questions regarding this *Notice* may be directed to Susan M. DeMando, Associate Vice President, Financial Operations, at (202) 728-8411, or Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, at (202) 974-2974.

Background and Discussion

Section 7(a) of the Securities Exchange Act of 1934 (the Exchange Act) authorizes the Board of Governors of the Federal Reserve System to prescribe the rules and regulations regarding credit that may be extended by broker-dealers on securities to their customers as set forth in Regulation T. Currently, Rule 2520 (Margin Requirements) prescribes minimum maintenance margin requirements for customer accounts held by members based on

position or strategy-based margin requirements. This methodology applies prescribed margin percentage requirements to each security position and/or strategy, either long or short, held in a customer's account. The Board of Governors of the Federal Reserve System, in its amendments to Regulation T in 1998, permitted self-regulatory organizations to implement portfolio margin rules, subject to SEC approval.²

Accordingly, NASD has amended Rule 2520 to allow members on a pilot basis, subject to specified conditions, to elect to apply a portfolio margin methodology to all margin equity securities,³ listed options, security futures products,⁴ unlisted derivatives,⁵ warrants, index warrants and related instruments.⁶ In addition, a member, provided that it is a Futures Commission Merchant (FCM) and is either a clearing member of a futures clearing organization or has an affiliate that is a clearing member of a futures clearing organization, is permitted to combine an eligible participant's related instruments with listed index options, unlisted derivatives, options on exchange traded funds (ETF), index warrants and underlying instruments,⁷ and compute a margin requirement for such combined products on a portfolio margin basis.

The rule change is substantially similar to recent margin rule amendments by the New York Stock Exchange (NYSE) and the Chicago Board Options Exchange (CBOE), which were approved by the SEC.⁸ Consistent with the NYSE and CBOE programs, the rule change is available as a pilot beginning on April 2, 2007, and ending on July 31, 2007, unless the SEC approves an extension of the pilot or adoption of the program on a permanent basis.

Portfolio Margin

Portfolio margining is a margin methodology that sets margin requirements for an account based on the greatest projected net loss of all positions in a product class or group⁹ using computer modeling to perform risk analysis using multiple pricing scenarios. These scenarios are designed to measure the theoretical loss of the positions given changes in both the underlying price and implied volatility inputs to the model. Accordingly, the margin required is based on the greatest loss that would be incurred in a portfolio if the value of its components move up or down by a predetermined amount.

Margin Calculation

Under the rule change, a gain or loss on each position in the portfolio is calculated on each of 10 equidistant points along a range representing a potential percentage increase and decrease in the value of the instrument or underlying instrument in the case of a derivative product. For portfolios of only highly capitalized broad-based indexes, the range is between a market increase of 6 percent and a decrease of 8 percent. For non-highly capitalized broad-based indexes, the range is +/- 10 percent. For portfolios of equity options, narrow-based index options and/or security futures, the risk-array for computing the portfolio margin requirement is up/down market moves of +/-15 percent.

For options with the same underlying security (or index in the case of an index option), the underlying security itself and any related futures, options on futures or security futures products could be combined as a portfolio for purposes of computing a portfolio margin requirement. The SEC-approved theoretical options pricing model is used to derive position values at each valuation point for the purpose of determining the gain or loss.¹⁰ The gains and losses are netted to derive a potential portfolio gain or loss for the point. The margin requirement for the portfolio is the amount of the greatest loss among the calculation points. Certain portfolios are allowed offsets such that, at the same valuation point, a gain in one portfolio may reduce or offset the loss in another portfolio. The amount of offset allowed between portfolios is the same that is permitted under SEC Rule 15c3-1a for computing a broker-dealer's Net Capital. The margin requirement for each portfolio then is added together to calculate the total margin requirement for the portfolio margin account.

In addition, the rule change prescribes a minimum margin requirement of \$0.375 for each listed option, unlisted derivative, security futures product, and related instrument multiplied by the contract or instrument's multiplier.

Generally, a customer benefits from portfolio margining in that margin requirements calculated on net position risk are generally lower than strategy-based margin methodologies currently in place. In permitting margin computation based on actual net risk, members no longer are required to compute a margin requirement for each individual position or strategy in a customer's account.

Monitoring and Risk Management

As a pre-condition to permitting portfolio margining, a member is required to establish a comprehensive written risk analysis methodology to assess the potential risk to the member's capital over a specified range of possible market movements. The written risk analysis methodology must include procedures and guidelines for (1) obtaining and reviewing account documentation and financial information to assess the amount of credit to be extended to eligible participants; (2) the determination, review and approval of credit limits to each eligible participant, and across all eligible participants, utilizing a portfolio margin account; (3) monitoring credit risk exposure to the member's capital, on both an intra-day and end of day basis, including the type, scope and frequency of reporting to senior management; (4) the use of stress testing of portfolio margin accounts in order to monitor market risk exposure from individual accounts and in the aggregate; (5) the regular review and testing of the procedures by an independent unit; (6) managing the impact of credit extended related to portfolio margin accounts on the member's overall risk exposure; (7) the appropriate response by management when credit extensions have been exceeded; and (8) determining when additional margin may need to be collected.

A member is required to periodically review its credit extension activities for consistency with its guidelines and determine if the data necessary to apply portfolio margining is accessible on a timely basis, and information systems are available to adequately capture, monitor, analyze and report relevant data.

Approval Required to Use Portfolio Margin Methodology

A member that wishes to use a portfolio margin methodology must file an application with NASD, or the member's designated examining authority (DEA) if other than NASD, and receive approval from NASD or the member's DEA if other than NASD, prior to establishing a portfolio margin methodology for eligible participants. The application must be fully documented and should address, at minimum, the following:

- a. Opening of portfolio margin accounts;
- b. The profile of customers who will be eligible for portfolio margining, including the initial approval process to be applied by the firm;
- c. A description of minimum equity requirements for each customer;
- d. The determination, review and approval of credit limits for each customer and across all customers;
- e. A description of any internal model used to determine risk in individual customer accounts, including the documentation for such model;
- f. A description of correlation assumptions included in any internal models used for assessing the adequacy of margin in a customer's account;
- g. A description of the stress testing scenarios that are performed on the accounts, the frequency of such testing and the results of the most recent stress test;
- h. Monitoring of accounts to assess if the account contains a portfolio of hedged instruments;
- i. Identification of security concentrations within an account;
- j. Identification of concentrations in individual securities across customer accounts;
- k. Intra-day monitoring of exposure in customer accounts;
- l. Detection, prevention and circumvention of day trading requirements;
- m. Monitoring of limitation on credit extended on portfolio margin accounts to 10 times the member's Net Capital;
- n. A description of the process for obtaining the TIMS theoretical values and the process used to compute margin requirements in individual customer accounts;
- o. A description of house margin requirements if they differ from the TIMS requirement;
- p. A description of exception reports that will be used to monitor margin exposure;
- q. A description of the escalation procedures to alert senior management of unusual risks;
- r. The regular review and testing of the risk analysis procedures by an independent unit such as internal audit or other comparable group;

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- s. If an organization would like to provide portfolio margin to customers in unlisted derivatives, the application should include a description of the products as well as a detailed description of the credit analysis and collateral management process that will be used to monitor any exposure that may result to the member. This information may be submitted to NASD at a later date if unlisted derivatives are not being offered to customers on the implementation date; and
 - t. An organizational chart identifying those persons primary responsible for portfolio margin risk management and the person or persons to whom they report.

Members seeking approval to participate in the portfolio margining pilot must submit the application providing the information set forth above to Susan M. DeMando, Associate Vice President, Financial Operations, 1735 K Street, NW, Washington, D.C. 20006. In order for members to be eligible for approval by the effective date of the pilot on April 2, 2007, the application must be submitted to NASD no later than March 2, 2007.

Eligible Participants

The rule change permits the following persons to engage in portfolio margining: (1) any broker or dealer registered pursuant to Section 15 of the Exchange Act; (2) any member of a national futures exchange to the extent that listed index options, unlisted derivatives, options on ETFs, index warrants or underlying instruments hedge the member's index futures; and (3) any person approved to engage in uncovered option contracts, and if security futures are to be included in the account, approval for such transactions is also required. However, an eligible participant under category (3) may not establish or maintain positions in unlisted derivatives unless minimum equity of at least five million dollars is established and maintained with the member. If the account of an eligible participant subject to the five million dollar requirement falls below such minimum requirement, it must be restored within three business days. A member is prohibited from accepting new opening orders beginning on the fourth business day, except for new opening orders entered solely for the purpose of reducing market risk, where the result would be to lower margin requirements.

Margin Deficiencies

Under the rule change, eligible participants are required to satisfy a margin deficiency in a portfolio margin account within three business days by the deposit of additional funds and/or securities, or by the establishment of a hedge that would reduce margin requirements. In the event the deficiency is not satisfied after three business days, the member must liquidate positions to eliminate the deficiency. A member is required to deduct from its Net Capital the amount of any margin deficiency not satisfied by the close of business on the next business day after the business day on which the deficiency arises, and continuing until the deficiency is satisfied. Members should not permit an eligible participant to make a practice of meeting a portfolio margin deficiency by liquidation and are required to identify accounts that periodically liquidate positions to eliminate margin deficiencies. However, liquidation to eliminate margin deficiencies that are caused solely by adverse price movements may be disregarded.

Establishing Account

Members are permitted to use a specific securities margin account or a sub-account of a margin account clearly identified as a portfolio margin account. The account must be separate from any other securities account. In the event a portfolio margin account is a subaccount of a regular margin account, a member is allowed to use excess equity in the regular margin account to meet a margin deficiency in the portfolio margin account. In addition, securities, including money market funds, that are not eligible for portfolio margin treatment are allowed to be carried in a portfolio margin account for their collateral value, subject to the margin requirement applicable in a regular securities margin account.

Day Trading

The day trading restrictions in Rule 2520 do not apply to a portfolio margin account that establishes and maintains at least five million dollars in equity, provided that a member has the ability to monitor the intra-day risk associated with day trading. A portfolio margin account that does not establish and maintain at least five million dollars in equity is otherwise subject to the day trading restrictions. However, if the position or positions day traded were part of a hedge strategy, the day trading restrictions do not apply. A "hedge strategy" for purposes of the rule means a transaction or a series of transactions reduces or offsets a material portion of the risk in a portfolio. Members are expected to monitor portfolio margin accounts to detect and prevent circumvention of the day trading requirements.

Net Capital Treatment

Under the rule change, the aggregate portfolio margin and maintenance requirements may not exceed ten times the member's Net Capital, as computed under SEC Rule 15c3-1. This requirement places a ceiling on the amount of portfolio margin a broker-dealer can extend to its customers.

Disclosure Document

NASD Rule 2860(b)(11) prescribes requirements for the delivery of options disclosure documents concerning the opening of customer accounts. Under the rule change, members are required to provide every portfolio margin customer with a written risk disclosure statement at or prior to the initial transaction in a portfolio margin account. The disclosure will be in a format prescribed by NASD or in a format developed by the member, provided it contains substantially similar information as in the prescribed NASD format and has received the prior written approval of NASD. NASD will issue a subsequent *Notice to Members* to set forth the language required in the written disclosure statement.

Effective Date

The rule change establishes a pilot program that begins on April 2, 2007, and ends on July 31, 2007, to conform to the time periods of the similar portfolio margin pilot programs of the NYSE and CBOE.

As discussed above, members seeking approval to participate in the portfolio margining pilot must submit an application that includes the specified information to Susan M. DeMando, Associate Vice President, Financial Operations, 1735 K Street, NW, Washington, D.C. 20006. In order for members to be eligible for approval by the effective date of April 2, 2007, applications must be submitted to NASD no later than March 2, 2007.

Endnotes

- 1 See SR-NASD-2007-013 filed on February 12, 2007. Under Section 19(b) of the Securities Exchange Act of 1934, the SEC has the authority to summarily abrogate this type of rule change within 60 days of filing.
- 2 See Federal Reserve System, "Securities Credit Transactions; Borrowing By Broker and Dealers"; Regulations G, T, U and X; Dockets Nos. R-0905, R-0923 and R-0944, 63 FR 2806 (January 16, 1998).
- 3 For purposes of the rule, the term "margin equity security" uses the definition at Section 220.2 of Regulation T of the Board of Governors of the Federal Reserve System.
- 4 For purposes of the rule, "security futures product" uses the definition at Section 3(a)(56) of the Exchange Act.
- 5 For purposes of the rule, the term "unlisted derivatives" is defined in Rule 2520(g)(2)(H).
- 6 For purposes of the rule, the term "related instrument" is defined in Rule 2520(g)(2)(D).
- 7 For purposes of the rule, the term "underlying instrument" is defined in Rule 2520(g)(2)(G).
- 8 See Exchange Act Release No. 54918 (December 12, 2006), 71 FR 75790 (December 18, 2006) (SR-NYSE-2006-13, relating to further amendments to the NYSE's portfolio margin pilot program); Exchange Act Release No. 54125 (July 11, 2006), 71 FR 40766 (July 18, 2006) (SR-NYSE-2005-93, relating to amendments to the NYSE's portfolio margin pilot program); Exchange Act Release No. 52031 (July 14, 2005) 70 FR 42130 (July 21, 2005) (SR-NYSE-2002-19, relating to the NYSE's original portfolio margin pilot). See also Exchange Act Release No. 54919 (December 12, 2006), 71 FR 75781 (December 18, 2006) (SR-CBOE-2006-014, relating to amendments to the CBOE's portfolio margin pilot); Exchange Act Release No. 52032 (July 14, 2005) 70 FR 42118 (July 21, 2005) (SR-CBOE-2002-03, relating to the CBOE's original portfolio margin pilot).
- 9 Products would be grouped into a single portfolio that is based on the same index or issuer.
- 10 Currently, the only model that is approved by the SEC is The Options Clearing Corporation's Theoretical Intermarket Margining System (TIMS).

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ATTACHMENT A

New language is underlined.

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2520. Margin Requirements

(a) through (f) No Change.

(g) Portfolio Margin

As an alternative to the “strategy-based” margin requirements set forth in paragraphs (a) through (f) of this Rule, members may elect to apply the portfolio margin requirements set forth in this paragraph (g) to all margin equity securities,¹ listed options, security futures products (as defined in Section 3(a)(56) of the Exchange Act), unlisted derivatives, warrants, index warrants and related instruments, provided that the requirements of paragraph (g)(6)(B)(i) of this Rule are met.

In addition, a member, provided that it is a Futures Commission Merchant (“FCM”) and is either a clearing member of a futures clearing organization or has an affiliate that is a clearing member of a futures clearing organization, is permitted under this paragraph (g) to combine an eligible participant’s related instruments as defined in paragraph (g)(2)(D), with listed index options, unlisted derivatives, options on exchange traded funds (“ETF”), index warrants and underlying instruments and compute a margin requirement for such combined products on a portfolio margin basis.

The portfolio margin provisions of this Rule shall not apply to Individual Retirement Accounts (“IRAs”).

(1) Monitoring. - Members must monitor the risk of portfolio margin accounts and maintain a comprehensive written risk analysis methodology for assessing the potential risk to the member’s capital over a specified range of possible market movements of positions maintained in such accounts. The risk analysis methodology shall specify the computations to be made, the frequency of computations, the records to be reviewed and maintained, and the person(s) within the organization responsible for the risk function. This risk analysis methodology must be filed with NASD, or the member’s designated examining authority (“DEA”) if other than NASD, and submitted to the Commission prior to the implementation of portfolio margining. In performing the risk analysis of portfolio margin accounts required by this Rule, each member shall include in the written risk analysis methodology procedures and guidelines for:

(A) obtaining and reviewing the appropriate account documentation and financial information necessary for assessing the amount of credit to be extended to eligible participants;

(B) the determination, review and approval of credit limits to each eligible participant, and across all eligible participants, utilizing a portfolio margin account;

(C) monitoring credit risk exposure to the member from portfolio margin accounts, on both an intra-day and end of day basis, including the type, scope and frequency of reporting to senior management;

(D) the use of stress testing of portfolio margin accounts in order to monitor market risk exposure from individual accounts and in the aggregate;

(E) the regular review and testing of these risk analysis procedures by an independent unit such as internal audit or other comparable group;

(F) managing the impact of credit extended related to portfolio margin accounts on the member's overall risk exposure;

(G) the appropriate response by management when limits on credit extensions related to portfolio margin accounts have been exceeded; and

(H) determining the need to collect additional margin from a particular eligible participant, including whether that determination was based upon the creditworthiness of the participant and/or the risk of the eligible product.

Moreover, management must periodically review, in accordance with written procedures, the member's credit extension activities for consistency with these guidelines. Management must periodically determine if the data necessary to apply this paragraph (g) is accessible on a timely basis and information systems are available to adequately capture, monitor, analyze and report relevant data.

(2) Definitions. - For purposes of this paragraph (g), the following terms shall have the meanings specified below:

(A) The term "listed option" means any equity-based or equity index-based option traded on a registered national securities exchange or automated facility of a registered national securities association.

(B) The term "portfolio" means any eligible product, as defined in paragraph (g)(6)(B)(i), grouped with its underlying instruments and related instruments.

(C) The term "product group" means two or more portfolios of the same type (see table in paragraph (g)(2)(F)below) for which it has been determined by SEC Rule 15c3-1a that a percentage of offsetting profits may be applied to losses at the same valuation point.

(D) The term “related instrument” within a security class or product group means broad-based index futures and options on broad-based index futures covering the same underlying instrument. The term “related instrument” does not include security futures products.

(E) The term “security class” refers to all listed options, security futures products, unlisted derivatives, and related instruments covering the same underlying instrument and the underlying instrument itself.

(F) The term “theoretical gains and losses” means the gain and loss in the value of individual eligible products and related instruments at ten equidistant intervals (valuation points) ranging from an assumed movement (both up and down) in the current market value of the underlying instrument. The magnitude of the valuation point range shall be as follows:

<u>Portfolio Type</u>	<u>Up / Down Market Move (High & Low Valuation Points)</u>
<u>High Capitalization, Broad-based Market Index²</u>	<u>+6% / -8%</u>
<u>Non-High Capitalization, Broad-based Market Index³</u>	<u>+/- 10%</u>
<u>Any other eligible product that is, or is based on, an equity security or a narrow-based index</u>	<u>+/- 15%</u>

(G) The term “underlying instrument” means a security or security index upon which any listed option, unlisted derivative, security future, or broad-based index future is based.

(H) The term “unlisted derivative” means any equity-based or equity index-based unlisted option, forward contract, or security-based swap that can be valued by a theoretical pricing model approved by the Commission.

(3) Approved Theoretical Pricing Models. - Theoretical pricing models must be approved by the Commission.

(4) Eligible Participants. - The application of the portfolio margin provisions of this paragraph (g) is limited to the following:

(A) any broker or dealer registered pursuant to Section 15 of the Exchange Act;

(B) any member of a national futures exchange to the extent that listed index options, unlisted derivatives, options on ETFs, index warrants or underlying instruments hedge the member’s index futures; and

(C) any person or entity not included in paragraphs (g)(4)(A) and (g)(4)(B) above approved for uncovered options and, if transactions in security futures are to be included in the account, approval for such transactions is also required. However, an eligible participant under this paragraph (g)(4)(C) may not establish or maintain positions in unlisted derivatives unless minimum equity of at least five million dollars is established and maintained with the member. For purposes of this minimum equity requirement, all securities and futures accounts carried by the member for the same eligible participant may be combined provided ownership across the accounts is identical. A guarantee pursuant to paragraph (f)(4) of this Rule is not permitted for purposes of the minimum equity requirement.

(5) Opening of Accounts

(A) Members must notify and receive approval from NASD, or the member's DEA if other than NASD, prior to establishing a portfolio margin methodology for eligible participants.

(B) Only eligible participants that have been approved to engage in uncovered short option contracts pursuant to NASD Rule 2860, or the rules of the member's DEA if other than NASD, are permitted to utilize a portfolio margin account.

(C) On or before the date of the initial transaction in a portfolio margin account, a member shall:

(i) furnish the eligible participant with a special written disclosure statement describing the nature and risks of portfolio margining which includes an acknowledgement for all portfolio margin account owners to sign, attesting that they have read and understood the disclosure statement, and agree to the terms under which a portfolio margin account is provided (see NASD Rule 2860(c)); and

(ii) obtain the signed acknowledgement noted above from the eligible participant and record the date of receipt.

(6) Establishing Account and Eligible Positions

(A) For purposes of applying the portfolio margin requirements prescribed in this paragraph (g), members are to establish and utilize a specific securities margin account, or sub-account of a margin account, clearly identified as a portfolio margin account that is separate from any other securities account carried for an eligible participant.

A margin deficit in the portfolio margin account of an eligible participant may not be considered as satisfied by excess equity in another account. Funds and/or securities must be transferred to the deficient account and a written record created and maintained. However, if a portfolio margin account is carried as a sub-account of a margin account, excess equity in the margin account (determined in accordance with the rules applicable to a margin account other than a portfolio margin account) may be used to satisfy a margin deficit in the portfolio margin sub-account without having to transfer any funds and/or securities.

(B) Eligible Products

(i) For eligible participants as described in paragraphs (g)(4)(A) through (g)(4)(C), a transaction in, or transfer of, an eligible product may be effected in the portfolio margin account. Eligible products under this paragraph (g) consist of:

(a) a margin equity security (including a foreign equity security and option on a foreign equity security, provided the foreign equity security is deemed to have a "ready market" under SEC Rule 15c3-1 or a "no-action" position issued thereunder, and a control or restricted security, provided the security has met the requirements in a manner consistent with SEC Rule 144 or a Commission "no-action" position issued thereunder, sufficient enough to permit the sale of the security, upon exercise or assignment of any listed option or unlisted derivative written or held against it, without restriction);

(b) a listed option on an equity security or index of equity securities;

(c) a security futures product;

(d) an unlisted derivative on an equity security or index of equity securities;

(e) a warrant on an equity security or index of equity securities; and

(d) a related instrument as defined in paragraph (g)(2)(D).

(7) Margin Required. - The amount of margin required under this paragraph (g) for each portfolio shall be the greater of:

(A) the amount for any of the ten equidistant valuation points representing the largest theoretical loss as calculated pursuant to paragraph (g)(8) below; or

(B) for eligible participants as described in paragraph (g)(4)(A) through (g)(4)(C), \$.375 for each listed option, unlisted derivative, security future product, and related instrument, multiplied by the contract's or instrument's multiplier, not to exceed the market value in the case of long contracts in eligible products.

(C) Account guarantees pursuant to paragraph (f)(4) of this Rule are not permitted for purposes of meeting margin requirements.

(D) Positions other than those listed in Paragraph (g)(6)(B)(i) above are not eligible for portfolio margin treatment. However, positions not eligible for portfolio margin treatment (except for ineligible related instruments) may be carried in a portfolio margin account, provided the member has the ability to apply the applicable strategy-based margin requirements promulgated under this Rule. Shares of a money market mutual fund may be carried in a portfolio margin account, also subject to the applicable strategy-based margin requirement under this Rule provided that:

(i) the customer waives any right to redeem shares without the member's consent;

(ii) the member (or, if the shares are deposited with a clearing organization, the clearing organization) obtains the right to redeem shares in cash upon request;

(iii) the fund agrees to satisfy any conditions necessary or appropriate to ensure that the shares may be redeemed in cash, promptly upon request; and

(iv) the member complies with the requirements of Section 11(d)(1) of the Exchange Act and SEC Rule 11d1-2 thereunder.

(8) Method of Calculation

(A) Long and short positions in eligible products, including underlying instruments and related instruments, are to be grouped by security class; each security class group being a "portfolio." Each portfolio is categorized as one of the portfolio types specified in paragraph (g)(2)(F) above, as applicable.

(B) For each portfolio, theoretical gains and losses are calculated for each position as specified in paragraph (g)(2)(F) above. For purposes of determining the theoretical gains and losses

at each valuation point, members shall obtain and utilize the theoretical values of eligible products as described in this paragraph (g) rendered by an approved theoretical pricing model.

(C) Offsets. Within each portfolio, theoretical gains and losses may be netted fully at each valuation point. Offsets between portfolios within the eligible product groups, as described in paragraph (g)(2)(F), may then be applied as permitted by SEC Rule 15c3-1a.

(D) After applying the offsets above, the sum of the greatest loss from each portfolio is computed to arrive at the total margin required for the account (subject to the per contract minimum).

(E) In addition, if a security that is convertible, exchangeable, or exercisable into a security that is an underlying instrument requires the payment of money or would result in a loss if converted, exchanged, or exercised at the time when the security is deemed an underlying instrument, the full amount of the conversion loss is required.

(9) Portfolio Margin Minimum Equity Deficiency

(A) If, as of the close of business, the equity in the portfolio margin account of an eligible participant as described in paragraph (g)(4)(C), declines below the five million dollar minimum equity required, if applicable, and is not restored to at least five million dollars within three business days by a deposit of funds and/or securities or through favorable market action, members are prohibited from accepting new opening orders beginning on the fourth business day, except that new opening orders entered for the purpose of reducing market risk may be accepted if the result would be to lower margin requirements. This prohibition shall remain in effect until,

(i) equity of five million dollars is established, or

(ii) all unlisted derivatives are liquidated or transferred from the portfolio margin account to the appropriate securities account.

(B) Members will not be permitted to deduct any portfolio margin minimum equity deficiency amount from Net Capital in lieu of collecting the minimum equity required.

(10) Portfolio Margin Deficiency

(A) If, as of the close of business, the equity in the portfolio margin account of an eligible

participant, as described in paragraph (g)(4)(A) through (g)(4)(C), is less than the margin required, the eligible participant may deposit additional funds and/or securities or establish a hedge to meet the margin requirement within three business days. After the three business day period, members are prohibited from accepting new opening orders, except that new opening orders entered for the purpose of reducing market risk may be accepted if the result would be to lower margin requirements. In the event an eligible participant fails to hedge existing positions or deposit additional funds and/or securities in an amount sufficient to eliminate any margin deficiency after three business days, the member must liquidate positions in an amount sufficient to, at a minimum, lower the total margin required to an amount less than or equal to the account equity.

(B) If the portfolio margin deficiency is not met by the close of business on the next business day after the business day on which such deficiency arises, members will be required to deduct the amount of the deficiency from Net Capital until such time the deficiency is satisfied or positions are liquidated pursuant to paragraph (g)(10)(A) above.

(C) Members will not be permitted to deduct any portfolio margin deficiency amount from Net Capital in lieu of collecting the margin required.

(D) NASD, or the member's DEA if other than NASD, may grant additional time for an eligible participant to meet a portfolio margin deficiency upon written request, which is expected to be granted in extraordinary circumstances only.

(E) Notwithstanding the provisions of subparagraph (B) above, members should not permit an eligible participant to make a practice of meeting a portfolio margin deficiency by liquidation. Members must have procedures in place to identify accounts that periodically liquidate positions to eliminate margin deficiencies, and the member is expected to take appropriate action when warranted. Liquidation to eliminate margin deficiencies that are caused solely by adverse price movements may be disregarded.

(11) Determination of Value for Margin Purposes. - For the purposes of this paragraph (g), all eligible products shall be valued at current market prices. Account equity for the purposes of paragraphs (g)(9)(A) and (g)(10)(A) shall be calculated separately for each portfolio margin account by adding the current market value of all long positions, subtracting current market value of all short positions, and adding the credit (or subtracting the debit) balance in the account.

(12) Net Capital Treatment of Portfolio Margin Accounts

(A) No member that requires margin in any portfolio account pursuant to paragraph (g)

of this Rule shall permit the aggregate portfolio margin requirements to exceed ten times its Net Capital for any period exceeding three business days. The member shall, beginning on the fourth business day, cease opening new portfolio margin accounts until compliance is achieved.

(B) If, at any time, a member's aggregate portfolio margin requirements exceed ten times its Net Capital, the member shall immediately transmit telegraphic or facsimile notice of such deficiency to the principal office of the Commission in Washington, D.C., the district or regional office of the Commission for the district or region in which the member maintains its principal place of business; and to NASD, or the member's DEA if other than NASD. Notice to NASD shall be in such form as NASD may prescribe.

(13) Day Trading Requirements. - The day trading restrictions promulgated under paragraph (f)(8)(B) of this Rule shall not apply to portfolio margin accounts that establish and maintain at least five million dollars in equity, provided that a member has the ability to monitor the intra-day risk associated with day trading. Portfolio margin accounts that do not establish and maintain at least five million dollars in equity will be subject to the day trading restrictions under paragraph (f)(8)(B) of this Rule, provided the member has the ability to apply the applicable day trading requirement under this Rule. However, if the position or positions day traded were part of a hedge strategy, the day trading restrictions will not apply. A "hedge strategy" for purposes of this Rule means a transaction or a series of transactions that reduces or offsets a material portion of the risk in a portfolio. Members are expected to monitor these portfolio margin accounts to detect and prevent circumvention of the day trading requirements.

(14) Requirements to Liquidate

(A) A member is required immediately either to liquidate, or transfer to another broker-dealer eligible to carry portfolio margin accounts, all portfolio margin accounts with positions in related instruments if the member is:

(i) insolvent as defined in section 101 of title 11 of the United States Code, or is unable to meet its obligations as they mature;

(ii) the subject of a proceeding pending in any court or before any agency of the United States or any State in which a receiver, trustee, or liquidator for such debtor has been appointed;

(iii) not in compliance with applicable requirements under the Exchange Act or rules of the Commission or any self-regulatory organization with respect to financial

responsibility or hypothecation of eligible participant's securities; or

(iv) unable to make such computations as may be necessary to establish compliance with such financial responsibility or hypothecation rules.

(B) Nothing in this paragraph (g)(14) shall be construed as limiting or restricting in any way the exercise of any right of a registered clearing agency to liquidate or cause the liquidation of positions in accordance with its by-laws and rules.

(15) Members must ensure that portfolio accounts are in compliance with Rule 2860.

- 1 For purposes of this paragraph (g) of the Rule, the term "margin equity security" utilizes the definition at Section 220.2 of Regulation T of the Board of Governors of the Federal Reserve System.
- 2 In accordance with paragraph (b)(1)(i)(B) of SEC Rule 15c3-1a (Appendix A to SEC Rule 15c3-1), 17 CFR 240.15c3-1a(b)(1)(i)(B).
- 3 See footnote 2.

* * * * *

2860. Options

(a) through (b) No Change.

(c) Portfolio Margining Disclosure Statement and Acknowledgement

The special written disclosure statement describing the nature and risks of portfolio margining, and acknowledgement for an eligible participant signature, required by Rule 2520(g)(5)(C) shall be in a format prescribed by NASD or in a format developed by the member, provided it contains substantially similar information as in the prescribed NASD format and has received the prior written approval of NASD.

Notice to Members

FEBRUARY 2007

SUGGESTED ROUTING

Corporate Financing
Legal & Compliance
Registration
Senior Management
Branch Office
Initial Public Offering

KEY TOPICS

Office of Supervisory Jurisdiction
Registration
Rule 2711 (Research Analysts and
Research Reports)
Rule 3010 (Supervision)
Rule Harmonization
Supervision

REQUEST FOR COMMENT

Rule Harmonization

NASD Requests Comment on Proposed Amendments to Rules 3010(g) and 2711 in connection with the Rule Harmonization Project with the NYSE; **Comment Period Expires March 26, 2007**

Executive Summary

NASD is issuing this *Notice to Members* to solicit comments from members and other interested parties on a proposal to amend Rule 3010(g) (Supervision - Definition of "Office of Supervisory Jurisdiction") and Rule 2711 (Research Analysts and Research Reports - Definition of "Initial Public Offering").

Early last year, the New York Stock Exchange (NYSE) and NASD announced a plan to work jointly to harmonize their rulebooks in an effort to eliminate duplicative rules and streamline regulation. Further, on November 28, 2006, NASD and the NYSE announced a plan to consolidate their member regulation operations into a new organization that will be the single self-regulatory organization (SRO) for all securities firms doing business with the public in the U.S. The consolidation plan sets forth a more sensible and less complex regulatory system that will make securities regulation more efficient and effective.

The new SRO will work diligently toward the creation of single rulebook; however, the rule harmonization plan discussed in this NTM is a separate endeavor from the rulebook consolidation project. NASD believes that continuation of the rule harmonization project at this time remains a critical step toward ending duplication and reducing regulatory inefficiency.

Accordingly, NASD is issuing this *Notice to Members* to solicit comments from members and interested persons on the first round of proposed rules changes as part of the harmonization effort. NASD is proposing to amend Rule 3010(g)(2) to eliminate the definition of "Office of Supervisory Jurisdiction" and adopt definitions for a "supervisory branch office," a "limited supervisory branch office," a "non-supervisory branch office" and "non-branch office." NASD is also seeking comment on a proposal to amend Rule 2711 to define the term "initial public offering" consistent with the definition of such term in NYSE Rule 472.

Action Requested

NASD requests comment on the proposed amendments. Comments must be received by March 26, 2007. Members and interested persons can submit their comments using the following methods:

- Emailing comments to pubcom@nasd.com
- Mailing comments in hard copy to:

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

Important Notes: The only comments that will be considered are those submitted pursuant to the methods set forth above. All comments received in response to this *Notice* will be made available to the public on the NASD Web site. Generally, comments will be posted on the NASD Web site one week after the end of the comment period.¹

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

Questions/Further Information

As noted, hard copy comments should be submitted to Barbara Z. Sweeney. Questions concerning this *Notice* should be directed to Kosha K. Dalal, Associate General Counsel, Office of General Counsel, at (202) 728-6903.

Background

Rule Harmonization Project

Early last year, NASD and the NYSE announced a plan to work jointly to harmonize their rulebooks in an effort to eliminate duplicative rules and streamline regulation. A series of industry committees was convened to assist in the detailed work required to bring the two rulebooks into line. The industry committees reviewed a wide range of rules, including all rules in the NASD and NYSE manuals covering sales practices, supervision, financial and operational obligations, registration, and qualification and continuing education requirements.

Further, on November 28, 2006, NASD and the NYSE announced a plan to consolidate their member regulation operations into a new organization that will be the single SRO for all securities firms doing business with the public in the U.S. On January 19, 2007, NASD member firms approved By-Law changes necessary for the proposed consolidation. The consolidation plan sets forth a more sensible and less complex regulatory system that will make securities regulation more efficient and effective. The By-Laws amendments will be sent to the Securities and Exchange Commission (SEC) for approval. NASD currently expects to have all the necessary approvals and a final agreement with the NYSE completed in the second quarter of 2007.

NASD believes that continuation of the rule harmonization project at this time remains a critical step toward ending duplication and reducing regulatory inefficiency. As part of an initial round of changes, NASD is soliciting comment on proposed amendments to Rules 3010(g)(1) and 2711.

Discussion

Rule 3010(g)(1)

Rule 3010(g)(1) defines the term "Office of Supervisory Jurisdiction" to mean any office of a member at which any one or more of the following functions take place: (a) order execution and/or market making; (b) structuring of public offerings or private placements; (c) maintaining custody of customers' funds and/or securities; (d) final acceptance (approval) of new accounts on behalf of the member; (e) review and endorsement of customer orders, pursuant to paragraph (d) above; (f) final approval of advertising or sales literature for use by persons associated with the member, pursuant to Rule 2210(b)(1); or (g) responsibility for supervising the activities of persons associated with the member at one or more other branch offices of the member.

One recommendation of the industry committee was that NASD consider eliminating its definition of OSJ to prevent locations where the only activity being conducted is principal review and approval of research reports from being classified as branch offices under Rule 3010(g).

In July 2006, amendments to NASD's branch office definition under Rule 3010(g)(2) went into effect (Uniform Branch Office Definition). The Uniform Branch Office Definition was developed collectively by NASD, the NYSE and NASAA to establish a broad national standard. In conjunction with the new Uniform Branch Office Definition, a new Form BR was introduced to provide a more efficient, standardized method for members to register branch office locations.

While the SROs have sought to adopt consistent interpretations of the new Uniform Branch Office Definition, NASD and the NYSE have different classifications of a location where final approval by a principal of research reports occurs. Under NASD's current rules, final review of advertising or sales literature (which includes research reports) makes a location an OSJ, and therefore a branch office. The NYSE, however, does not have an OSJ definition and stated in NYSE *Information Memorandum 06-13* that it deems a location where a member stations a Series 16 qualified supervisory analyst solely to review research reports as a "non-sales location," which is an express exclusion from the Uniform Branch Office Definition.³ Because of NASD's OSJ definition, NASD could not permit such locations to qualify as "non-sales locations" under the Uniform Branch Office Definition.

This inconsistency led the industry committee to recommend that NASD consider eliminating its OSJ definition to prevent such locations from being treated differently by the two SROs.

As a result, NASD is proposing to eliminate the definition of OSJ from NASD's rulebook. In its place, NASD proposes to adopt express definitions for the terms "supervisory branch office," "limited supervisory branch office," "non-supervisory branch office," and "non-branch locations." NASD believes this proposal will simplify the current structure by clearly delineating, in one rule, four classifications for member offices and the supervisory and inspection obligations that attach to each. In addition, with the proposed elimination of the term "OSJ," locations that conduct only final review of research reports would no longer be classified as OSJs and thereby required to register as branch offices. Such locations would become "non-branch locations."

The functions that currently make a location an OSJ would be captured in a proposed new definition of "supervisory branch office." A "supervisory branch office" would be any location that performs all the functions currently included in the OSJ definition, except for locations at which the only activity being conducted is the final review of research reports. A location that supervises one or more other supervisory branch offices, one or more limited supervisory branch offices, or one or more non-supervisory branch offices would be deemed a "supervisory branch office." A main office of a member may qualify as a supervisory branch office. Like the current system for OSJs, an appropriately registered principal would have to be on-site at a supervisory branch office as provided in Rule 3010(a)(4) and such location would be subject to an annual inspection cycle as provided in Rule 3010(c)(1)(A).

A “limited supervisory branch office” would be any location of the member that supervises one or more non-branch locations and does not supervise any supervisory branch offices or any other limited supervisory branch offices. A main office of a member may qualify as a limited supervisory branch office. Like the current system, such location would be subject to branch office registration and would be subject to an annual inspection cycle as provided in Rule 3010(c)(1)(A). But, the office would not be required to have an appropriately registered principal on-site as provided in Rule 3010(a)(4).

A “non-supervisory branch office” would be any location of the member that satisfies the definition of branch office, but does not qualify as a supervisory branch office or limited supervisory branch office. A main office of a member may qualify as a non-supervisory branch office. Like the current system for non-OSJ branch offices, a non-supervisory branch office would be subject to branch office registration, but would not be required to have an appropriately registered principal on-site, but must have one or more appropriately registered representatives or principals on-site with authority to carry out the supervisory responsibilities assigned to that office by the member (“person-in-charge”) as provided in Rule 3010(a)(4), and such location would be subject to inspection at least every three years as provided in Rule 3010(c)(1)(B).

A “non-branch location” would be any location of the member, including but not limited to a main office, that does not qualify as a supervisory branch office, a limited supervisory branch office, or a non-supervisory branch office. In addition, a “non-branch location” would include any of the following locations, provided such locations do not engage in any other activities that would require branch office registration: (A) a location that qualifies for an exclusion from the definition of “branch office” pursuant to Rule 3010(g)(2); (B) a location that engages solely in final approval of research reports by a person registered in a principal capacity (or equivalent NYSE registration category, e.g., Series 16) for use by persons associated with the member pursuant to Rule 2210(b)(1) provided no other sales functions are conducted and the location is not held out to the public as a branch office; (C) a location that engages solely in soliciting a member’s “investment banking services” as defined in NASD Rule 2711 (and NYSE Rule 472.20) provided no other sales functions are conducted and the location is not held out to the public as a branch office; or (D) a location that engages solely in proprietary trading or securities lending provided no other sales functions are conducted and the location is not held out to the public as a branch office.⁴ A non-branch location would not be required to register as a branch office. Further, a non-branch location would be permitted to engage in a combination of the activities described above provided the location does not engage in any activities that would otherwise require branch office registration. Non-branch locations would not be required to have an appropriately registered principal on-site and would be subject to a regular inspection cycle established by the member as provided in Rule 3010(c)(1)(C).

Rule 2711

Rule 2711 (Research Analysts and Research Reports), among other things, imposes quiet periods after an initial public offering during which a member is prohibited from publishing or otherwise distributing research and also restricts research analysts from purchasing or owning certain securities issued before a company's initial public offering. NASD Rule 2711 does not, however, define the term "initial public offering."

The industry committee recommended that NASD add an express definition of the term "initial public offering" for purposes of its research analyst rule to make it consistent with the NYSE research analyst rule. NYSE Rule 472 defines the term "initial public offering" for purposes of NYSE's research analyst rule as "the initial registered equity security offering by an issuer, regardless of whether such issuer is subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, prior to the time of the filing of such issuer's registration statement."

Specifically, Rule 2711(f)(1) provides that a member may not publish or otherwise distribute a research report and that a research analyst may not make a public appearance regarding a subject company for which the member has acted as manager or co-manager of, among other things, an initial public offering for 40 calendar days following the date of the offering. Rule 2711(f)(2) imposes a 25-day quiet period after an initial public offering on any other member that has agreed to participate or is participating as an underwriter or dealer in such offering.⁵ Further, Rule 2711(g)(1) restricts a research analyst from purchasing or receiving any securities before an issuer's initial public offering if the issuer is principally engaged in the same types of businesses as the companies that the research analyst follows.

While Rule 2711 does not expressly define the term "initial public offering," NASD has interpreted the term as used in Rule 2711 to have the same meaning as in NYSE Rule 472. As a result, NASD is proposing to amend Rule 2711 to codify this interpretation.

Endnotes

- 1 See *Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments). Personal identifying information, such as names or email addresses, will not be edited from submissions. Submit only information that you wish to make publicly available.
- 2 Section 19 of the Securities Exchange Act (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and the rules thereunder.
- 3 See *NYSE Information Memorandum 06-13* (March 22, 2006) Joint Interpretive Guidance from NYSE and NASD Relating to the Uniform Branch Office Definition, Question and Answer #5.
- 4 Proposed subparagraphs (C) and (D) are currently excluded from the Uniform Branch Office Definition in *Notice to Members 06-12* and *NYSE Information Memorandum 06-13* as qualifying for the “non-sales location” exclusion. The proposal would amend the rule text to reflect these exclusions.
- 5 A proposed rule change pending with the Commission would amend the rule to establish a unified 25-day quiet period for all underwriters and dealers, irrespective of whether a member acts as a lead or co-manager.

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Disciplinary and Other NASD Actions

REPORTED FOR FEBRUARY

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

Firms Fined, Individuals Sanctioned

Horace Mann Investors, Inc. (CRD #11643, Springfield, Illinois), Sherman Marc Bloom (CRD #2875366, Registered Representative, Curwensville, Pennsylvania) and Jerry Deamus Scott (CRD #1371721, Registered Representative, Afton, Tennessee) submitted Letters of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Bloom was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. Scott was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the findings, the respondents consented to the described sanctions and to the entry of findings that Bloom and Scott affixed public customers' signatures to forms without the customers' knowledge or consent. The findings stated that the firm failed to promptly and accurately file with NASD an amended Rule 3070 Report and failed to amend Scott's Uniform Application for Securities Industry Registration or Transfer (Form U4) to disclose a written complaint alleging forgery.

Bloom's suspension in any capacity was in effect from January 2, 2007, through January 31, 2007. Scott's suspension in any capacity is in effect from January 2, 2007, through March 2, 2007. (NASD Cases #E8A2005011501/E8A2005011502/E8A2005011503)

Prudential Equity Group, LLC fka Prudential Securities, Inc. (CRD #7471, New York, New York) and Gary Earl Evans (CRD #1148015, Registered Representative, Lubbock, Texas) submitted Letters of Acceptance, Waiver and Consent in which the firm was censured and fined \$125,000. Evans was fined \$7,500 and suspended from association with any NASD member in a principal capacity for 45 days. Without admitting or denying the findings, the firm and Evans consented to the described sanctions and to the entry of findings that a branch office of the firm failed to establish and maintain a system to supervise its registered representatives' activities reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules. The findings stated that the firm's supervisory system failed to detect the activities of a registered representative engaged

in an outside business activity, and Evans did not review correspondence the representative received and facsimile correspondence he sent. The findings also stated that the firm's supervisory system was deficient in that it had inadequate procedures regarding review of customer account statements to detect irregular activity in the representative's customer accounts, and failed to follow up on a "red flag" that might have uncovered the representative's Ponzi scheme. The findings also included that the firm, acting through Evans, failed to adequately investigate the nature of a business entity and to monitor the entity's account that would have revealed additional "red flags." NASD found that Evans failed to conduct any further investigation regarding the representative's outside business activities including calling customers, reviewing statements and verifying financial arrangements, but instead relied on the representative's statements.

The suspension in a principal capacity is in effect from January 16, 2007, through March 1, 2007. (NASD Cases #2005001720501/200500172 0502)

Firms and Individuals Fined

Aladdin Capital LLC (CRD #103766, Stamford, Connecticut) and George McMurray Marshman (CRD #2170808, Registered Principal, Darien, Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which they were censured and fined \$10,000, jointly and severally, and an additional \$5,000 fine was imposed against the firm. Without admitting or denying the findings, the firm and Marshman consented to the described sanctions and to the entry of findings that the firm, acting through Marshman, permitted an associated person of the firm to function as its chief compliance officer and perform various supervisory functions without being registered as a principal with NASD. The findings also stated that the firm failed to conduct independent testing for compliance with its anti-money laundering (AML) program and to provide for ongoing training for appropriate personnel. (NASD Case #2006003873401)

Firms Fined

AllianceBernstein Investments, Inc. (CRD #14549, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$100,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it provided non-cash compensation to associated persons of other NASD member firms in connection with the sale and distribution of investment company securities. The findings stated that the firm failed to have systems and procedures in place that were reasonably designed to ensure compliance with NASD Rule 2830(L)(5) concerning non-cash compensation in connection with the sale of investment company securities. (NASD Case #SAF2004016001)

Ameritrade, Inc. (CRD #5633, Bellevue, Nebraska) submitted a Letter of Acceptance, Waiver and Consent in which the firm 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 establish and maintain a supervisory system and written procedures designed to achieve compliance with the applicable securities laws, regulations and NASD rules regarding FDIC-insured products the firm offered through unregistered, non-member third party entities. (NASD Case #E0420040450-01)

Banc of America Investment Services, Inc., (CRD #16361, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$500,000 and required to pay \$89,625, plus interest, in restitution to public customers. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to establish and maintain a supervisory system and procedures reasonably designed to review and monitor its fee-based brokerage business. The findings stated that as a result of these deficiencies, the firm allowed customers to continue in fee-based accounts (the Portfolio Edge Accounts) without assessing whether those accounts remained appropriate for those customers, and did not have procedures in place requiring its brokers to determine whether a Portfolio Edge Account was appropriate for a customer before opening the account. The findings also stated that the firm used written communications with the public,

including advertising and sales literature, to market the account that omitted material information and failed to provide a sound basis for evaluating the facts in regard to the account. (NASD Case #EAF0401010002)

Block Orders Execution, LLC (CRD #134932, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$11,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to implement a system that allowed the firm to adequately retain and retrieve instant messages that registered representatives sent and received. The findings also stated that the firm failed to apply for the research analyst designation for a registered representative and for a supervisory designation for any of the firm's principals to supervise a registered representative's activity in his capacity as a research analyst. The findings also stated that the firm failed to adopt or implement written supervisory procedures reasonably designed to ensure compliance with research analyst rules. The findings also included that the firm permitted an associated person to act in a capacity requiring registration as a general securities representative without being properly registered in that capacity. (NASD Case #2006003890801)

Capital Portfolio Management, Inc. (CRD #29302, Hunt Valley, Maryland) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$24,000, ordered to pay \$2,134, plus interest, in restitution to public customers and revise the firm's written supervisory procedures regarding fair pricing and markups. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it bought/sold securities for its own account from/to other broker-dealers and failed to buy/sell the securities to/from firm customers at a price that was fair, taking into consideration all relevant circumstances including market conditions with respect to the securities at the time of transaction, the expense involved and that the firm was entitled to a profit. 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 fair pricing and markups. (NASD Case #20050022304-01)

Cowen and Company, LLC (CRD #7616, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$30,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it effected short sales in securities for the firm's proprietary account(s) and failed to make/annotate an affirmative determination that the firm could borrow the securities or otherwise provide for delivery of the securities by the settlement date. The findings stated that the firm failed to timely report Reportable Order Events to the Order Audit Trail SystemSM (OATSSM) and transmitted reports to OATS that contained inaccurate, incomplete or improperly formatted data. The findings also stated that the firm failed to submit required order information for an order to OATS and combined order/route reports for other orders. The findings also included that the firm made available on the covered orders in national market system securities that it received for execution from any person that included incorrect information as to order execution statistics for multiple categories and failed to correctly classify a covered limit order into the correct order type and size category. (NASD Case #20050002690-03)

Deutsche Bank Securities, Inc. (CRD #2525, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$25,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it submitted an incorrect "order sent" timestamp for orders routed to its affiliates to OATS, and as a result, route reports failed to match to either of the affiliate's related new order reports. (NASD Case #20050014655-01)

DWS Scudder Distributors, Inc. (CRD #37306, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$425,000 and required to review its policies and procedures concerning non-cash compensation. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it provided non-cash compensation to the associated persons of other NASD member firms in connection with the sale and distribution of investment company securities and variable annuities. The findings also stated that the firm failed to have adequate systems and procedures in place to ensure it complied

with NASD Rules 2830 and 2820 concerning non-cash compensation in connection with the sale of investment company securities and variable annuities. (NASD Case #EAF0401460001)

Evergreen Investment Services, Inc. (CRD #487, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$4,200,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it participated in yearly shelf space-revenue sharing arrangements with an affiliated firm. The findings stated that in order to pay for participation in the revenue sharing program, the firm arranged for the affiliate to receive \$25.6 million in directed brokerage commissions over a three-year period. The findings also stated that the firm sponsored a sales-recognition program for registered representatives of the affiliate who sold certain target amounts of funds set by the firm that constituted the payment of improper non-cash compensation. (NASD Case #EAF0400970003)

Finantia USA Ltd. (CRD #39120, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$12,500. 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 TRACE-eligible transactions to the Trade Reporting and Compliance Engine (TRACE). The findings stated that the firm failed to indicate the contra MPID and instead inaccurately reported that the contra side was a customer as opposed to an inter-dealer, failed to report the yield for transactions, and erroneously reported one agency trade as a principal trade. The findings also stated that the firm's order tickets contained inaccurate information. The findings also included that the firm failed to establish, maintain and enforce written supervisory procedures addressing TRACE reporting. (NASD Case #20060037577-01)

First Montauk Securities Corporation (CRD #13755, Red Bank, New Jersey) 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 failed to enforce its written supervisory procedures regarding the review of customer addresses and customer address change requests by the firm's legal

and compliance departments. The findings stated that the firm failed to prevent a registered representative from having a back office clerk change customer addresses to post office boxes and to his home address in violation of firm written supervisory procedures. (NASD Case #2005001028302)

Legend Merchant Group, Inc. (CRD #5155, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$30,000 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 electronic communications relating to its business. The findings stated that the firm utilized a vendor to maintain and preserve electronic communications, and while the vendor initially captured those communications, the vendor could not later retrieve them and the firm failed to retain those communications. The findings also stated that the firm's TRACE-eligible securities transactions were reported late. (NASD Case #E102004024201)

Linsco/Private Ledger Corp. (CRD #6413, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$300,000 and required to retain an independent consultant to conduct a review to determine whether improvements for reviewing variable annuity exchanges have been appropriately implemented, whether supervisory personnel are conducting the reviews as prescribed and documenting their efforts, and whether the systems and procedures are adequate. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that the firm failed to establish, maintain and enforce an adequate supervisory system, including written procedures, reasonably designed to review and monitor its variable annuity exchange business. (NASD Case #EAF0400610003)

McKim Capital, Inc. (CRD #103814, Pleasanton, 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 engaged in a general

municipal securities business through the execution of unsolicited liquidating transactions in municipal securities for a public customer on a riskless principal basis. This activity comprised a material change in the firm's business for which it had not sought or obtained NASD's prior approval. The findings further stated that the firm conducted a municipal securities business without a qualified municipal securities principal and did not retain all electronic communications relating to its business. The findings also stated that the firm did not establish, maintain and enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with the requirements of the SEC and MSRB rules with respect to the retention of electronic communications. (NASD Case #E0120050052-01)

Moors & Cabot, Inc. (CRD #594, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$75,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report corporate bond transactions to TRACE and failed to timely report municipal securities transactions to the MSRB. The findings stated that the firm's order tickets for municipal securities, corporate and government bond transactions did not indicate whether the transactions were solicited or unsolicited, and in what capacity the firm was acting. (NASD Case #E112005019101)

National Securities Corporation (CRD #7569, Seattle, Washington) 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 report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of the execution time. 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 TRACE reporting. The findings also stated that the firm failed to report customer transactions in municipal securities to the MSRB within 15 minutes of the execution time. (NASD Case #20050004545-01)

Northland Securities, Inc. (CRD #40258, Minneapolis, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to deposit investor funds in an appropriate escrow account for private offerings and released investor funds before the minimum contingency was met with *bona fide* investments. The findings further stated that the firm rendered false and misleading representations in a private placement memorandum that investor funds would be released to the issuer only after the minimum contingency was met. (NASD Case #E0420050078-01)

Pinnacle Capital Markets, LLC (CRD #119606, Raleigh, North Carolina) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$12,500. 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 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's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning the execution and reporting of short sales. (NASD Case #20050008073-01)

Prudential Equity Group, LLC (CRD #7471, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$35,000 and required to revise the firm's written supervisory procedures regarding SEC Rules 10a-1, 11Ac1-6, Automated Confirmation Transaction ServiceSM (ACTSM) reporting, affirmative determination, registration, best execution, three quote rule, trade reporting, sales transactions, trading halts, soft dollar accounts, books and records, and limit order protection. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to provide written notification disclosing to its customers that transactions were executed at an average price; when it acted as principal for its own account, it failed to provide written notification disclosing to its customers that it was a market maker

in each security; and failed to provide written notification disclosing its correct capacity in transactions to its customers. The findings stated that the firm made available reports on covered orders in national market system securities that it received for execution from any person that included incomplete and incorrect information. The findings stated that the firm failed to correct a programming error found in its 2005 review that was brought to its attention as a result of the 2004 review. The findings included that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws and regulations concerning SEC Rule 10a-1, ACT reporting, registration, best execution, three quote rule, trade reporting, sales transactions and trading halts. NASD found that the firm failed to provide documentary evidence that it performed supervisory reviews set forth in its written supervisory procedures concerning the requirements of affirmative determination, SEC Rule 11Ac1-6, soft dollar accounts, books and records, and limit order protection. (NASD Case #20042000211-01)

Putnam Retail Management Limited Partnership (CRD #7325, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$175,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it provided non-cash compensation to associated persons of other NASD member firms in connection with the sale and distribution of investment company securities and variable annuity contracts. The findings stated that the firm failed to have adequate systems and procedures in place to ensure it complied with NASD rules 2820(g)(4) and 2830(L)(5) concerning non-cash compensation in connection with the sale of investment company securities and variable insurance contract. (NASD Case #SAF2004016601)

Redwood Brokerage, LLC (CRD #39416, 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 distributed research reports prepared by an entity affiliated with the firm that were deficient. The findings stated that the reports failed to contain the required research analysts' certifications

attesting to the nature of the views contained in the reports and their compensation. (NASD Case #E1020050359-02)

Royal Alliance Associates, Inc. (CRD #23131, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$20,000 and required to revise its written supervisory procedures regarding TRACE. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of the execution time. 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 TRACE. (NASD Case #20050014023-01)

Securities America, Inc. (CRD #10205, Omaha, Nebraska) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$225,000 and required to retain an independent consultant to conduct a review to determine whether certain improvements for reviewing variable annuity transactions have been appropriately implemented, whether supervisory personnel are conducting the reviews as prescribed and documenting their efforts, and whether the system and procedures are reasonable. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to establish and maintain an adequate supervisory system, including written procedures, reasonably designed to achieve compliance with applicable securities laws and regulations and NASD rules with respect to its variable annuity exchange business. (NASD Case #EAF0400600003)

SG Americas Securities, LLC (CRD #128351, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it effected short sales in securities for the firm's proprietary account and failed to make/annotate an affirmative determination that the firm could borrow the securities or otherwise provide for delivery of the securities by the settlement date. (NASD Case #20041000051-01)

Stillpoint Wealth Management, LLC (CRD #119154, Atlanta, Georgia) 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 failed to report municipal securities transactions within the time period MSRB Rule G-14 prescribes. The findings stated that the firm failed to develop and implement a written training plan and needs analysis for continuing education. **(NASD Case #2006003967201)**

Stoeber, Glass & Company, Inc. (CRD #7031, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report public customer bond transactions to TRACE. **(NASD Case #E1020050409-01)**

Utendahl Capital Partners, L.P. (CRD #30115, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$240,000 and required to submit to NASD quarterly reports for calendar years 2007, 2008 and 2009 audited by an independent public accountant in accordance with generally accepted accounting principles. The firm is also required to revise the firm's written supervisory procedures to ensure that the firm maintains accurate financial books and records, maintains sufficient excess net capital to meet contractual commitments related to the firm's underwriting activities and other financial obligations, maintains minimum required net capital, and files accurate Financial and Operational Combined Uniform Single (FOCUS) reports.

Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that the firm, acting through an individual, shared research reports prepared before their publication and published reports that did not disclose the valuation methods used to determine price targets. The findings also stated that the firm failed to preserve copies of all electronic mail for three years and/or maintain electronic mail for the first two years in an accessible location. The findings also stated that the firm permitted an individual to engage in securities business without being properly registered as a

principal, participated in municipal underwritings while not employing a qualified municipal securities principal, permitted an individual to take customer securities orders, cause orders to be executed and solicit transaction while not registered as general securities representatives. The findings also included that the firm did not comply with the Regulatory Element of the Continuing Education requirement and with the Firm Element of the Continuing Education requirement. NASD found that the firm provided inaccurate information to NASD staff. NASD also found that the firm failed to make adequate inquiries and conduct sufficient due diligence. In addition, NASD determined that the firm, acting through FINOPS, failed to establish and maintain ledgers and other records that accurately reflected all assets, liabilities and expenses, filed inaccurate FOCUS reports and while conducting a securities business, failed to maintain its minimum net capital requirements. The findings stated that the firm failed to give notice and/or timely notice under SEC Rule 17a-11 of material inadequacy, failed to timely file an annual audit report, failed to establish, maintain and enforce a supervisory system reasonably designed to insure its compliance with applicable laws, regulations and NASD rules regarding electronic correspondence, research and underwriting activities, and failed to properly update its supervisory procedures. **(NASD Case #E1020020590-03)**

Waddell & Reed, Inc. (CRD #866, Overland Park, Kansas) 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 ensure that a temporary employee was not engaging in activities requiring NASD registration. **(NASD Case #E062004029603)**

Wedbush Morgan Securities, Inc. (CRD #877, Los Angeles, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$150,000 and required to review its procedures regarding late trading and recordkeeping, and have systems in place reasonably designed to ensure compliance with the laws, regulations and rules including SEC Rule 22c-1(a) promulgated under the Investment Company Act of 1940. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that

it facilitated and permitted late trading, and failed to comply with the SEC "forward pricing rule." The findings stated that the firm failed to establish, maintain or enforce supervisory systems and written procedures reasonably designed to prevent and detect late trading. The findings also stated that the firm failed to create and maintain records that reflect the time of receipt of orders to purchase or sell mutual funds. **(NASD Case #E0220040229-01)**

Wedbush Morgan Securities, Inc. (CRD #877, Los Angeles, California) submitted an Offer of Settlement in which the firm was censured and fined \$32,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to accept or decline transactions in eligible securities in the NASDAQ Market Center (NMC) within 20 minutes after execution that the firm, as the order entry firm, was required to accept or decline. The findings stated that the firm failed, within 90 seconds after execution, to transmit last sale reports of transactions in OTC Equity securities through the NMC, and failed to designate some of them as late. The findings also stated that the firm submitted an inaccurate short interest position report to NASD. The findings also included 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 short interest reporting requirements contained in NASD Rule 3660. **(NASD Case #2004100023501)**

Individuals Barred or Suspended

Lionel H. Amron (CRD #4225665, Registered Representative, Beverly Hills, 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 10 business days. Without admitting or denying the findings, Amron consented to the described sanctions and to the entry of findings that he effected discretionary transactions in a public customer's accounts without having obtained the customer's prior written authorization and his member firm's prior written acceptance of the accounts as discretionary.

The suspension in any capacity was in effect from January 16, 2007, through January 29, 2007. **(NASD Case #20050006470-01)**

Brandon C. Allsup (CRD #5092387, Registered Representative, Jacksonville, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Allsup consented to the described sanction and to the entry of findings that, while taking the Series 7 examination, he possessed and used unauthorized study aides related to the content of the exam. **(NASD Case #2006005269601)**

Francis Preston Mark Brighton (CRD #30579, Registered Representative, Ephrata, 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, Brighton consented to the described sanction and to the entry of findings that he borrowed \$14,800 from public customers without his member firm's approval. The findings stated that Brighton failed to repay the loan by the agreed upon date, and failed to fully repay the customer. The filings also stated that in inducing and obtaining the loans, Brighton failed to disclose to the customers that he had obtained loans from other customers in the past and had not yet repaid those customers in full. **(NASD Case #2006006045201)**

Mark Vernon Brown (CRD #2233771, Registered Representative, New Port Richey, Florida) was barred from association with any NASD member in any capacity. The sanction was based on findings that Brown forged public customers' signatures on letters of authorization to authorize liquidations and transfers in their accounts, and forged a customer's signature on an annuity application. The findings stated that Brown executed transactions in customers' accounts without their knowledge or consent. The findings also stated that Brown falsely represented to his member firm that the source of the funds for additional investments was being made with new funds rather than with partial liquidations from pre-existing investments. The findings also included that Brown misrepresented account values to customers and omitted to disclose that their accounts had incurred surrender charges in connection with the liquidation of annuities. NASD found that Brown made unsuitable recommendations to public customers concerning annuity switches. NASD also found that Brown failed to comply with an NASD request to provide sworn testimony. **(NASD Case #2005000931301)**

Vicki L. Callaghan (CRD #2882042, Registered Representative, Everett, Washington) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. The fine must be paid before Callaghan reassociates with any NASD member following the suspension, or before she requests relief from any statutory disqualification. Without admitting or denying the findings, Callaghan consented to the described sanctions and to the entry of findings that she discovered that errors had been made in calculating the required minimum distribution for public customers' IRA accounts, and in order to rectify the errors, altered and submitted disbursement request forms to her member firm without the customers' knowledge, authorization or consent.

The suspension in any capacity is in effect from January 16, 2007, through March 16, 2007. (NASD Case #2005003415301)

Daniel Cardoso (CRD #4942763, Associated Person, Deltona, Florida) was barred from association with any NASD member in any capacity. The sanction was based on findings that Cardoso willfully failed to disclose material information on his Form U4 and failed to respond to NASD requests for information. (NASD Case #2005002564701)

Cynthia T. Carpenter (CRD #4571245, Registered Representative, Rustburg, Virginia) 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, Carpenter consented to the described sanction and to the entry of findings that she failed to respond to NASD requests for information. (NASD Case #2006004757401)

Charles Randall Cherry (CRD #716216, Registered Representative, Arden, North Carolina) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the findings, Cherry consented to the described sanctions and to the entry of findings that he sent a letter to a variable annuity issuer requesting that the issuer reallocate the sub-accounts in the variable annuities of many clients without his member firm's approval. The findings stated

that Cherry caused these changes to be effected based upon oral discretionary authority the clients gave him, although he had not obtained the clients' written discretionary authority, nor had he gotten his member firm to accept the accounts as discretionary accounts.

The suspension in any capacity was in effect from January 16, 2007, through January 29, 2007. (NASD Case #20060052299-01)

Jeffrey Robert Chicola (CRD #2686979, Registered Principal, Westfield, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Chicola reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Chicola consented to the described sanctions and to the entry of findings that he effected unauthorized trades in public customers' accounts. The findings stated that Chicola failed to reasonably supervise an individual to prevent and/or detect unauthorized trades. The findings also stated that Chicola settled a customer complaint without his member firm's knowledge or consent.

The suspension in any capacity is in effect from January 2, 2007, through January 1, 2009. (NASD Case #20050022347-01)

David Lee Clark (CRD #3052085, Registered Representative, Fort Collins, Colorado) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$14,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Clark reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Clark consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, without providing prompt written notice to, and receiving approval from, his member firm.

The suspension in any capacity is in effect from January 16, 2007, through July 15, 2007. (NASD Case #2006004838201)

Richard Crawford Clarke II (CRD #2306773, Registered Principal, Clive, Iowa) was barred from association with any NASD member in any capacity and ordered to pay \$38,000, plus interest, in restitution to public customers. The sanctions were based on findings that he borrowed \$38,000 from public customers even though his member firm's written supervisory procedures specifically prohibited registered representatives from borrowing money from customers except immediate family members. The findings stated that Clarke failed to respond to NASD requests for information. (NASD Case #2005000336401)

William R. Clemons (CRD #4985168, Associated Person, West Jordan, Utah) was barred from association with any NASD member in any capacity. The sanction was based on findings that Clemons willfully failed to disclose material information on his Form U4. The findings stated that Clemons failed to respond to NASD requests for information. (NASD Case #2005002743601)

Nancy Willinghurst Coppler (CRD #1630955, Registered Representative, Lexington, Kentucky) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. The fine must be paid before Coppler reassociates with any NASD member following the suspension, or before she requests relief from any statutory disqualification. Without admitting or denying the findings, Coppler consented to the described sanctions and to the entry of findings that she affixed a public customer's signature to a copy of a passport used as a secondary form of identification while attempting to open a money market account on the customer's behalf.

The suspension in any capacity was in effect from January 2, 2007, through January 31, 2007. (NASD Case #2006005456501)

Robert Anthony DeAngelis (CRD #63294, Registered Principal, East Northport, 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 30 days. Without admitting or denying the findings, DeAngelis consented to the described sanctions and

to the entry of findings that he altered a universal life insurance application after receiving a signed copy from a public customer, creating the impression that the customer had made the alterations, then sent the altered final version to the customer.

The suspension in any capacity was in effect from January 16, 2007, through February 14, 2007. (NASD Case #ELI20040402-01)

Sergio Diego III (CRD #4812372, Registered Representative, Miami, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Diego reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Diego consented to the described sanctions and to the entry of findings that he willfully failed to disclose a material fact on his Form U4.

The suspension in any capacity is in effect from January 2, 2007, through July 1, 2007. (NASD Case #2006005402701)

Shane Robert Douglas (CRD #4651892, Registered Representative, Longwood, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$6,205, suspended from association with any NASD member in any capacity for five months and ordered to pay \$3,795, plus interest, in restitution. The fine and restitution amounts must be paid before Douglas reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Douglas consented to the described sanctions and to the entry of findings that he knowingly and intentionally used the "no/was" function in ACT to improperly improve the terms of executions in his and his member firm's favor. The findings stated that Douglas intentionally or recklessly miscalculated average price transactions with correspondents to clear transactions reported to ACT with a non-clearing report.

The suspension in any capacity is in effect from November 20, 2006, through April 19, 2007. (NASD Case #20050000646-01)

Patrick Earl Egan (CRD #724199, Registered Principal, Kansas City, Missouri) 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 principal or supervisory capacity for 15 business days. Without admitting or denying the findings, Egan consented to the described sanctions and to the entry of findings that he did not adequately supervise a registered representative, in that he failed to detect and prevent the trades resulting from the representative's unsuitable recommendations to a public customer.

The suspension in a principal capacity was in effect from January 2, 2007, through January 23, 2007. (NASD Case #20050020878-02)

Peter Francis Esposito III (CRD #3018087, Registered Principal, Ontario, 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, Esposito consented to the described sanction and to the entry of findings that in connection with his recommendation and sale of a variable annuity to a public customer, he submitted falsified information to his member firm. The findings stated that Esposito falsely represented that the source of funds to pay for the transaction did not involve the replacement of an existing annuity; however, the proceeds originated from Esposito's liquidation of another variable annuity that he had previously sold to the customer. The findings also stated that Esposito failed to appear for an NASD on-the-record interview. (NASD Case #2005002689601)

Robert Stewart Evans (CRD #712252, Registered Supervisor, Mt. Pleasant, South Carolina) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Evans consented to the described sanction and to the entry of findings that he effected securities transactions in public customers' accounts without their knowledge or consent. The findings stated that Evans failed to respond to NASD requests for information. (NASD Case #2005002257101)

Jacques Andre Frym (CRD #1940809, Registered Representative, Richmond Hill, Georgia) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with

any NASD member in any capacity for six months. The fine must be paid before Frym reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Frym consented to the described sanctions and to the entry of findings that he willfully failed to disclose a material fact on his Form U4.

The suspension in any capacity is in effect from January 2, 2007, through July 1, 2007. (NASD Case #2006003841601)

William Alan Gay (CRD #1829623, Registered Principal, Golden, 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, Gay consented to the described sanction and to the entry of findings that he engaged in private securities transactions without providing prior written notice to, and receiving approval from, his member firm. The findings stated that Gay failed to provide complete testimony and to respond to NASD requests for documents and information. (NASD Case #2005003180901)

Paul Norman Germain (CRD #1351422, Registered Principal, Ankeny, Iowa) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Germain consented to the described sanction and to the entry of findings that, in his capacity as operations officer at his member firm, he converted shareholders' funds totaling \$184,337.96 by having mutual fund holdings liquidated and having the proceeds delivered to him by check or wired to his bank account. (NASD Case #20060041038-01)

Ronald Dwight Gooding (CRD #1136624, Registered Representative, Hamilton, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the findings, Gooding consented to the described sanctions and to the entry of findings that he engaged in outside business activities, for compensation, without providing prior written notice to his member firm.

The suspension in any capacity was in effect from January 2, 2007, through January 16, 2007. (NASD Case #2005000979601)

Harvey Scott Grossman (CRD #2545583, Registered Representative, Blue Bell, 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, Grossman consented to the described sanction and to the entry of findings that he failed to appear for an NASD on-the-record interview. (NASD Case #2006005578402)

Rocco Gerard Guidici Pietro (CRD #2489732, Registered Principal, Staten Island, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$113,035, which includes disgorgement of commissions received, and suspended from association with any NASD member in any capacity for one month. The fine must be paid before Guidici Pietro reassociates with a member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Guidici Pietro consented to the described sanctions and to the entry of findings that he engaged in a private placement offering through means of an offering memorandum that was false and misleading. The findings stated that the offering memorandum failed to disclose that Guidici Pietro would personally receive substantial commission payouts for all effected transactions and misrepresented the investment philosophy and trading strategy to be employed in the account, as well as the attendant risks.

The suspension in any capacity was in effect from January 16, 2007, through February 15, 2007. (NASD Case #E072003011203)

Norman Albert Harris (CRD #4309293, Registered Representative, Randallstown, Maryland) was barred from association with any NASD member in any capacity. The sanction was based on findings that Harris failed to respond to NASD requests for information. The findings further stated that Harris failed to provide his member firm with prompt written notice of his outside business activities. (NASD Case #2005001824501)

Ross Owen Haugen (CRD #1286021, Registered Supervisor, Plymouth, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 10 business days. The fine must be paid before Haugen reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Haugen consented to the described sanctions and to the entry of findings that he recommended securities transactions to a public customer that were not suitable in light of the customer's age, risk tolerance and investment objectives.

The suspension in any capacity was in effect from January 2, 2007, through January 16, 2007. (NASD Case #2005001763701)

Jay McCormick Jensen (CRD #258313, Registered Representative, St. Louis, Missouri) 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, Jensen consented to the described sanction and to the entry of findings that he failed to appear for an NASD on-the-record interview. (NASD Case #20060057744-01)

Angela Shuhui Kao (CRD #3003099, Registered Representative, Diamond Bar, California) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$10,000 and suspended from association with any NASD member in any capacity for 40 business days. The fine must be paid before Kao reassociates with any NASD member following the suspension, or before she requests relief from any statutory disqualification. Without admitting or denying the findings, Kao consented to the described sanctions and to the entry of findings that, while associated with a member firm, she maintained personal brokerage accounts at other member firms without giving prompt written notice to her member firm that she had accounts with those firms, and without notifying those firms of her association with her member firm. The findings stated that Kao participated in private securities transactions without giving prior written notice to her member firm.

The suspension in any capacity is in effect from January 16, 2007, through March 13, 2007. (NASD Case #20060041966-01)

Roger Angelo Kapsalis (CRD #2159293, Registered Representative, Brooklyn, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Kapsalis participated in a private securities transaction, failed to provide written notification to his member firm and failed to respond to NASD requests for information. **(NASD Case #20060053714-01)**

Michael William Keffler (CRD #1754242, Registered Principal, Lolo, Montana) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for two years. The fine must be paid before Keffler reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Keffler consented to the described sanctions and to the entry of findings that, while taking the Series 53 qualifications examination, he attempted to possess unauthorized materials for use during the examination.

The suspension in any capacity is in effect from January 16, 2007, through January 15, 2009. **(NASD Case #2006004480301)**

John Henry Kelly (CRD #2489408, Registered Representative, Cherry Hill, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Kelly reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Kelly 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 January 2, 2007, through July 1, 2007. **(NASD Case #2006004716901)**

Michael John Kman Jr. (CRD #1928664, Registered Representative, Enola, 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, Kman consented to the described sanction and to the entry of findings that he received checks totaling

\$131,600 from a public customer intended to be used for the customers' benefit. The findings stated that Kman deposited the checks into a bank account he owned and used a substantial portion of the funds for his own benefit without the customers' knowledge or authorization. The findings also stated that Kman failed to respond to NASD requests for information and failed to appear to provide testimony. **(NASD Case #2006004281301)**

Mark Kovler (CRD #4485423, Registered Representative, Briarcliff, 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 10 business days. The fine must be paid before Kovler reassociates with a member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Kovler consented to the described sanctions and to the entry of findings that he engaged in an outside business activity and failed to provide his member firm with prompt written notice of the transaction and the compensation he received.

The suspension in any capacity was in effect from December 18, 2006, through January 2, 2007. **(NASD Case #2006005195601)**

Myron Doyle Lester (CRD #3037832, Registered Representative, Upper Marlboro, Maryland) 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 Lester reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Lester consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing prior written notice to, or receiving written approval from, his member firm. The findings stated that Lester made a recommendation to a public customer without having a reasonable basis for believing that the recommendation was suitable based upon customer's investment objectives, financial status and needs. The findings also stated that in connection with the recommendation, Lester signed the customer's name to withdrawal forms and submitted them to

his member firm without giving any notice or other indication on the withdrawal forms that he had signed them on the customer's behalf.

The suspension in any capacity will be in effect from January 2, 2007, through January 1, 2008. **(NASD Case #2005002365301)**

Caliope Makris (CRD #4182361, Registered Representative, Poland, Ohio) was barred from association with any NASD member in any capacity. The sanction was based on findings that Makris failed to respond to NASD requests for information and that Makris affixed a public customer's signature to a disability application without noting that the application had been signed by someone other than the customer; thereby violating her member firm's prohibition against representatives signing documents on behalf of customers, even with the customer's consent. **(NASD Case #2005001405001)**

Scott Douglas Martis (CRD #1397512, Registered Representative, Charlotte, Michigan) submitted a Letter of Acceptance, Waiver and Consent in which he was suspended from association with any NASD member in any capacity for 10 business days. In light of Martis' financial status, no monetary sanctions have been imposed. Without admitting or denying the findings, Martis consented to the described sanction and to the entry of findings that he exercised discretion in a public customer's accounts without the customer's prior written authorization and his member firm's acceptance of the accounts as discretionary (in writing or otherwise).

The suspension in any capacity is in effect from January 16, 2007, through January 29, 2007. **(NASD Case #2005002502001)**

Jose Hernandez Manjarres (CRD #2718838, Registered Representative, Lincolnton, North 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, Manjarres consented to the described sanction and to the entry of findings that he effected, or caused to be effected, transactions in the joint account of public customers without their authorization, knowledge or consent. The findings stated that Manjarres failed to appear for an NASD on-the-record interview. **(NASD Case #2005001663001)**

Toby Allen McKnight (CRD #3065552, Registered Representative, Connellsville, Pennsylvania) was barred from association with any NASD member in any capacity. The sanction was based on findings that McKnight altered a Commission Override Form after signing it to reflect that he would receive 20 percent of future commissions rather than 10 percent, and he faxed the altered form to his member firm. The findings stated that McKnight failed to respond to NASD requests for information and failed to appear for an on-the-record interview. **(NASD Case #2005002806701)**

Rocco Anthony Mongelli (CRD #2746703, Registered Representative, Hillsdale, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the findings, Mongelli consented to the described sanctions and to the entry of findings that he induced a public customer to purchase a security by promising to place a stop loss order on the shares purchase, but failed to place the promised stop loss order and, as a result, the client suffered monetary losses. The findings stated that Mongelli transmitted an electronic mail message to a prospective customer that contained misleading statements that made unreasonable and baseless predictions regarding potential return on the customer's future investments.

The suspension in any capacity is in effect from January 2, 2007, through March 2, 2007. **(NASD Case #E102003200301)**

Theresa Jane Menz (CRD #4636567, Registered Representative, Columbus, Ohio) 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, Menz consented to the described sanction and to the entry of findings that, without a public customer's knowledge or consent, she withdrew \$4,327.78 funds from the customer's bank account for her own benefit. The findings stated that Menz converted funds from another customer's account in order to repay the funds she had previously taken from the other customer. **(NASD Case #2005003138901)**

Tony Seokoo Paik (CRD #2894154, Registered Representative, Suwanee, Georgia) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the findings, Paik consented to the described sanctions and to the entry of findings that he engaged in outside business activities for compensation and failed to provide prompt written notice to his member firm.

The suspension in any capacity was in effect from January 2, 2007, through January 31, 2007. (NASD Case #2005003466101)

Lamont Percell Parker (CRD #2946241, Registered Representative, Swarthmore, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the findings, Parker consented to the described sanctions and to the entry of findings that he affixed public customers' signatures to his member firm's proprietary forms to replace lost original forms and placed them in the customers' records as authentic.

The suspension in any capacity is in effect from January 2, 2007, through April 1, 2007. (NASD Case #2005002097001)

James Anthony Parrelly (CRD #728368, Registered Principal, Dearborn, Michigan) submitted an Offer of Settlement in which he was fined \$5,000, suspended from association with any NASD member in any capacity for 20 days and ordered to pay a public customer the amount agreed upon pursuant to their written agreement. Without admitting or denying the allegations, Parrelly consented to the described sanctions and to the entry of findings that he recommended and effected transactions in Class B shares of mutual funds for a public customer without having reasonable grounds for believing the resultant transactions were suitable for the customer who would have benefited from owning Class A shares in the identical funds. The findings stated that Parrelly recommended the customer sell Class B shares and later recommended that she purchase additional Class B shares of the same funds so that she was subjected to contingent deferred sales charges (CDSCs) as well as a new CDSC period associated with the new purchases.

The findings also stated that Parelly engaged in short-term trading of Class B shares within one year of the initial purchase, thereby subjecting the customer to a 5 percent CDSC in connection with the sale. The findings further stated that Parelly recommended that the customer use cash distributions from mutual fund positions to purchase additional shares of the same fund, generating new commissionable sales instead of reinvesting the shares with the fund group.

The suspension in any capacity was in effect from December 18, 2006, through January 6, 2007. (NASD Case #E8A2003033801)

Derek Ryan Pines (CRD #4428120, Registered Principal, Hoboken, New Jersey), Enrique Aguilera (CRD #2762032, Registered Representative, Hazlet, New Jersey) and Christopher Scott Conductor (CRD #4531589, Registered Representative, Long Branch, New Jersey) submitted Letters of Acceptance, Waiver and Consent in which Aguilera was fined \$15,000, suspended from association with any NASD member in any capacity for two months and required to pay \$900, plus interest, in restitution to a market maker. Conductor was fined \$30,000, suspended from association with any NASD member in any capacity for three months and ordered to pay \$2,482, plus interest, in restitution to market makers. Pines was fined \$10,000 and suspended from association with any NASD member in any capacity for 45 days. The fines are due and payable before each respondent reassociates with a member firm following their suspension or before requesting relief from any statutory disqualification.

Without admitting or denying the findings, Pines, Aguilera and Conductor consented to the described sanctions and to the entry of findings that they knowingly and intentionally entered through their member firm's proprietary trading account into NASDAQ's SuperMontage one-share or odd-lot orders to sell or buy NASDAQ securities from NASDAQ market makers that were utilizing an automated system to maintain a specific spread between its bid and offer for the securities. The findings stated that the respondents entered these one share or odd-lot sell or buy orders against the inside bid or offer when one of the market makers was quoting 100 shares at the NASDAQ Best Bid or Offer (QBBO) and received execution for these orders. The findings also stated that after the one-share or odd-lot orders were executed, the size of the market

maker's quote decremented to an odd lot of shares and the market maker's bid or offer moved to its next price level. The findings also included that after the QBBO changed, the respondents entered through the proprietary trading account into NASDAQ's Super Montage an order on the opposite side of the market to buy or sell at least 100 shares of the security, and received an execution order at the new QBBO from the same market maker that executed their orders. NASD found that by knowingly and intentionally engaging in this course of conduct, the respondents were able, on behalf of the firm's proprietary account, to sell or buy shares of the securities at prices that were higher or lower than they would otherwise have been able to obtain but for their entry and execution of their orders.

Pines' suspension in any capacity is in effect from January 2, 2007, through February 15, 2007. Aguilera's suspension in any capacity is in effect from January 2, 2007, through March 1, 2007. Concurso's suspension in any capacity is in effect from January 2, 2007, through April 1, 2007. (NASD Cases # 2005000029101/2005000029102/2005000029103)

Donald Chapman Pratt (CRD #367121, Registered Principal, Glastonbury, Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the findings, Pratt consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without providing prior written notice to, and receiving prior written approval from, his member firm.

The suspension in any capacity is in effect from February 5, 2007, through March 6, 2007. (NASD Case #2006004065001)

Robert Duane Ralston (CRD #801226, Registered Representative, Normal, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. The fine must be paid before Ralston reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Ralston consented to the described sanctions and to the entry of findings that he made changes to insurance application forms a public customer signed and affixed the customer's

initials to the changes with the customer's knowledge and consent and submitted the forms to his member firm to purchase life insurance for the customer, in contravention of his firm's written supervisory procedures.

The suspension in any capacity is in effect from January 16, 2007, through March 16, 2007. (NASD Case #E8A2004108101)

Alexis Jose Rivera (CRD #1656738, Registered Principal, Tampa, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Rivera consented to the described sanction and to the entry of findings that he engaged in a fraudulent trade allocation or "cherry picking" scheme, in that certain of his member firm's representatives aggregated retail customers' day trading orders and communicated an opening transaction to Rivera, who would work the order in a firm proprietary account to sometimes allocate a first profitable trade to a relative's personal account and the resulting loss to the customers' accounts. The findings stated that Rivera failed to give the affected customers best execution. (NASD Case #2005002440801)

Manuel Rose III (CRD #1424164, Registered Representative, Grand Rapids, Michigan) 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, Rose consented to the described sanction and to the entry of findings that he received \$22,000 from a public customer for investment, deposited the funds into his checking account and failed to make an investment on the customer's behalf. The findings also stated that Rose failed to respond to NASD requests for information. (NASD Case #2005000760301)

Soena Sahni (CRD #4514611, Registered Representative, Howell, New Jersey) 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, Sahni consented to the described sanction and to the entry of findings that she willfully failed to disclose material information on her Form U4. (NASD Case #2006004335701)

John Christopher Sanchez (CRD #3153473, Registered Representative, Mullica Hill, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Sanchez reassociates with a member firm following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Sanchez consented to the described sanctions and to the entry of findings that he willfully failed to amend his Form U4 to disclose material information.

The suspension in any capacity is in effect from January 2, 2007, through April 1, 2007. **(NASD Case #2006004709801)**

Mark Jeffrey Sheehy (CRD #2224709, Registered Representative, Scottsdale, Arizona) was barred from association with any NASD member in any capacity. The sanction was based on findings that Sheehy received \$97,500 from a public customer to be invested, deposited the funds into his bank account and executed numerous transactions in the customer's account without the customer's authorization, knowledge or consent. The findings further stated that Sheehy caused the transfer of funds from the customer's securities account for the purpose of causing the customer to believe that the funds represented a return on investment. The findings also stated that Sheehy failed to respond to NASD requests for information. **(NASD Case #20050005544-01)**

Kathleen Patricia Smith (CRD #3078908, Associated Person, Cincinnati, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 days. Without admitting or denying the findings, Smith consented to the described sanctions and to the entry of findings that she failed to disclose a material fact on her Form U4.

The suspension in any capacity was in effect from January 16, 2007, through February 14, 2007. **(NASD Case #2005001983701)**

Thomas Avery Smith (CRD #1134969, Registered Principal, Owensboro, Kentucky) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$35,000, suspended from association with any

NASD member in any capacity for two years and ordered to requalify by exam in all capacities. The fine must be paid before Smith reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Smith consented to the described sanctions and to the entry of findings that he falsified public customers' addresses to circumvent state securities laws because he was not licensed to sell securities in the state in which the customers resided, and he used his personal email account to communicate with the customers. The findings stated that Smith caused his member firm's books and records to be inaccurate by causing account information for public customers to contain incorrect addresses for him to circumvent state securities laws. The findings also stated that Smith sent written communications to public customers that failed to provide a sound basis for evaluating the presented information and contained numerous false, exaggerated, unwarranted or misleading statements and claims regarding investments.

The suspension in any capacity is in effect from January 2, 2007, through January 1, 2009. **(NASD Case #2005001028301)**

Adam Michael Stafford (CRD #4332433, Registered Representative, Canby, 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 30 days. The fine must be paid before Stafford reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Stafford consented to the described sanctions and to the entry of findings that he settled customer complaints and did not notify his member firm regarding the settlements.

The suspension in any capacity was in effect from January 16, 2007, through February 14, 2007. **(NASD Case #2006004408901)**

Donald Joseph Tittle (CRD #4855119, Associated Person, Middletown, Connecticut) was barred from association with any NASD member in any capacity. The sanction was based on findings that Tittle received \$27,000 from public customers to purchase stock, and deposited the funds in a bank account he controlled without purchasing the stock. The findings stated that

Tintle falsely represented that he held various securities licenses and falsely assured a public customer that she owned the stock. The findings also stated that Tintle failed to respond to NASD requests for information and documents. (NASD Case #2005003330001)

John Christopher Trimmings (CRD #2257118, Registered Principal, Gansevoort, 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, Trimmings consented to the described sanction and to the entry of findings that he received \$60,821.89 from a public customer for investment. The findings stated that without the customer's knowledge or consent, Trimmings misappropriated at least \$56,000 of the funds for his own use and benefit. (NASD Case #2006006124001)

Michael Weinraub (CRD #864247, Registered Representative, Wyckoff, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$15,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the findings, Weinraub consented to the described sanctions and to the entry of findings that he failed to respond completely to NASD questions during a telephone interview.

The suspension in any capacity is in effect from December 20, 2006, through February 17, 2007. (NASD Case #20050027076-01)

Christopher Anderson Weinrich (CRD #1462725, Registered Representative, Kansas City, Missouri) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$11,247.00, which includes \$1,247 in disgorgement, and suspended from association with any NASD member in any capacity for 30 business days. The fine must be paid before Weinrich reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, Weinrich consented to the described sanctions and to the entry of findings that he recommended securities transactions to a public customer without having reasonable grounds for believing that the recommendations were suitable in light of the customer's financial situation and needs.

The suspension in any capacity was in effect from January 2, 2007, through February 13, 2007. (NASD Case #20050020878-01)

Blain Anthony West (CRD #5004618, Registered Representative, Tillamook, 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 60 days. The fine must be paid before West reassociates with any NASD member following the suspension, or before he requests relief from any statutory disqualification. Without admitting or denying the findings, West consented to the described sanctions and to the entry of findings that, during an internal audit, he was required to provide the file for a corporate customer and found that the Corporate Authorization to Open Account was missing a signature. The findings stated that, in order to avoid a problem with the bank's internal auditors, West made a copy of the missing individual's signature from another document and placed it on the Corporate Authorization without the individual's knowledge or consent.

The suspension in any capacity is in effect from January 16, 2007, through March 16, 2007. (NASD Case #2006005007801)

Monica Blair Yates (CRD #1999021, Registered Representative, Fincastle, Virginia) 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, Yates consented to the described sanction and to the entry of findings that she obtained possession of two checks drawn against a public customer's credit union account totaling \$139,700 to be used to pay the customer's federal and state taxes he owed in connection with withdrawals from his 401k account. The findings stated that without the customer's knowledge or authorization, Yates deposited the checks into her personal account and used the funds for her own benefit. The findings also state that Yates failed to respond fully to NASD requests for information and documents. (NASD Case #2006005593501)

Decision Issued

The Office of Hearing Officers (OHO) issued the following decision, which has been appealed to or called for review by the NAC as of December 31, 2006. The NAC may increase, decrease, modify, or reverse the findings and sanctions imposed in the decision. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notice to Members*.

CMG Institutional Trading, LLC (CRD #47264, Chicago, Illinois) and Shawn Derrick Baldwin (CRD #4281564, Registered Principal, Chicago, Illinois). The firm was expelled from NASD membership and Baldwin was barred from association with any NASD member in any capacity. The sanctions were based on findings that the firm and Baldwin failed to respond to NASD requests for information and documents.

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #E8A2005025201)

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.

William George Gibson (CRD #2381501, Registered Representative, Myrtle Beach, South Carolina) was named as a respondent in an NASD complaint alleging that he received checks totaling \$22,025 from public customers for investment purposes but instead, deposited the funds in an account he controlled and did not make any investments on the customers' behalf. The complaint alleges that Gibson failed to appear for an NASD on-the-record interview to provide testimony. (NASD Case #2006004260001)

Kevin Guzman (CRD #4497415, Registered Principal, New York, New York) was named as a respondent in an NASD complaint alleging that Guzman's trading activity in the account of public customers was unsuitable and excessive in size and frequency in view of the customers' financial situation and needs. The complaint alleges that Guzman's pattern and level of trading activity considered in light of the customers' financial situation and needs demonstrated his purpose to derive a profit for himself at the customers' expense. The complaint also alleges that Guzman churned and excessively traded the account. The complaint further alleges that Guzman, by use of any means or instrumentality of interstate commerce or of the mails, intentionally or recklessly engaged in manipulative or deceptive devices or contrivances in connection with the purchase or sale of securities, and intentionally or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive or other fraudulent devices or contrivances. In addition, the complaint alleges that Guzman created documents that contained inaccurate and misleading information concerning the customers' financial profile and needs that the customers signed and submitted with their account applications. Furthermore, the complaint alleges that Guzman made misrepresentations to a public customer regarding his account. (NASD Case #20050000720-02)

Jason Charles Midgley (CRD #4623081, Registered Representative, Boynton Beach, Florida) was named as a respondent in an NASD complaint alleging that he participated in private securities transactions without providing any notice to his member firm describing in detail the transactions, his proposed role in the transactions and whether he had received, or might receive, compensation in connection with the transactions. The complaint alleges that Midgley recommended and effected unsuitable transactions in a public customer's account. The complaint also alleges that Midgley failed to respond to NASD requests for information and to appear for on-the-record testimony. (NASD Case #2005002411701)

Jonathan David Poland (CRD #4456200, Registered Representative, Fort Lauderdale, Florida) was named as a respondent in an NASD complaint alleging that he effected securities transactions in a public customer's account without the the customer's knowledge or consent to engage in the transactions.

The complaint alleges that Poland failed to appear for an NASD on-the-record interview and to provide information. (NASD Case #2005000895501)

S.G. Martin Securities LLC (CRD #46908, Jericho, New York), Paul Michael Giarmoleo (CRD #2096430, Registered Principal, Miller Place, New York), Emanuel Pantelakis (CRD #3074986, Registered Principal, Flushing, New York) and Keith Craig Baron (CRD #3231494, Registered Representative, Merrick, New York) were named as respondents in an NASD complaint alleging that Pantelakis, acting on his member firm's behalf, authorized the firm and Giarmoleo to recommend stocks to public customers without having a reasonable basis for doing so, and without having reviewed current financial statements and material business information for providing a reasonable basis for recommending the stocks. Giarmoleo, in recommending a stock, without a reasonable basis for doing so, made price predictions to customers, and Pantelakis and Giarmoleo omitted material information in the selling. The complaint alleges that the firm, Pantelakis, Giarmoleo and Baron, in connection with the purchase or sale of securities, and by the use of means or instrumentalities of interstate commerce or by the mails, directly or indirectly, knowingly or recklessly employed devices, schemes or artifices to defraud; made untrue statements of material facts or omissions to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or engaged in acts, practices or courses of business that operated, or would operate, as a fraud or deceit upon any person. The complaint also alleges that Pantelakis, acting on the firm's behalf, recommended that Baron solicit customers to buy a stock in a private placement without having a reasonable basis for recommending the stock or for believing it was suitable for public customers. In recommending the private placement, Baron made price predictions. The complaint also alleges that the firm and Baron caused one customer's account to buy a stock without the customer's authorization.

The complaint further alleges that Pantelakis and Baron recommended that customers buy the stock in the secondary market without a reasonable basis for the recommendations or for believing the stock was suitable, and omitted material information in their recommendations. In recommending the buy in the secondary market, Baron made price predictions to customers. In addition, the complaint alleges that Pantelakis, on the firm's behalf, falsified a new account form, causing his firm to make and keep a false record. Furthermore, the complaint alleges that the firm and Pantelakis failed to establish, maintain and enforce a system to supervise the activities of each representative and associated person that was reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules; failed to establish, maintain and enforce written procedures to supervise the types of businesses in which the firm engaged; and failed to supervise the sales practices of Pantelakis, Giarmoleo, Baron and others. The complaint alleges that Pantelakis testified falsely in an NASD on-the-record interview. (NASD Case #2005000191701)

Ronald Vaughn (CRD #453836, Registered Representative, Voorhees, New Jersey) was named as a respondent in an NASD complaint alleging that he falsely represented to an insurance company that a customer's liquidation of a fixed annuity check had never been received and requested that another check to be issued. The complaint alleges that Vaughn endorsed the liquidation check thereby converting \$74,240.41 to his own use and benefit without the permission or consent of the insurance company and the customer. The complaint also alleges that Vaughn failed to respond to NASD requests to appear for an on-the-record interview. The complaint further alleges that Vaughn willfully failed to amend his Form U4 to disclose material information. (NASD Case #2006004213401)

Tomy Vuksanaj (CRD #4267663, Registered Representative, New Rochelle, New York) was named as a respondent in an NASD complaint alleging that he converted \$83,600 from public customers' accounts by forging their signatures on falsified bank account withdrawal slips without their knowledge, authorization or consent. (NASD Case #20060042995-01)

Firms Expelled for Failure to Pay Fines and/or Costs

Beacon Global Advisors Inc.
North Bethesda, Maryland
(December 11, 2006)

Equity Planning Securities Corp. nka Draken Group, Inc.
Lawrenceville, Georgia
(December 11, 2006)

Firm Suspended for Failing to Pay Arbitration Awards

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

Trautman Wasserman & Company, Inc.
New York, New York
(December 19, 2006)

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

Khalid Abdul-Ghany
Philadelphia, Pennsylvania
(December 11, 2006)

Kevin Edward Davis
Baltimore, Maryland
(December 11, 2006)

Adam Robert Goldstein
Lake Mary, Florida
(December 11, 2006)

John Henry Groth
North Bethesda, Maryland
(December 11, 2006)

John F. Wilkinson
Birmingham, Michigan
(December 11, 2006)

Individuals Barred Pursuant to NASD Rule 9552(h)

Mohammed Kariuki Ali
Hackensack, New Jersey
(December 14, 2006)

Elliot M. Hershberg
Harrison, New York
(February 18, 2005)

David Lee McMillan
Bullhead City, Arizona
(December 27, 2006)

Barton Lee Richardson
Lebanon, Ohio
(December 4, 2006)

Omar Rodriguez
Perth Amboy, New Jersey
(December 27, 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.)

Michael Joseph Fabiano
Yardley, Pennsylvania
(December 12, 2006)

Robert Thomas Maloney
Buffalo, New York
(December 11, 2006)

Thomas McGovern
New York, New York
(December 4, 2006)

William Earl Rice Jr.
Humble, Texas
(December 18, 2006)

Lewis Taylor Smith
Dallas, Texas
(December 6, 2006)

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

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

Adam R. Ayers
Columbus, Ohio
(December 27, 2006)

Heath Michael Barrett
Ocala, Florida
(December 28, 2006)

Jason Albertson Bishara
Massapequa Park, New York
(November 30, 2006, to December 28, 2006)

Timothy James Daly
Weston, Connecticut
(December 27, 2006)

Carlos Antonio Garceran
Mendham, New Jersey
(December 20, 2006)

Cheryl Diane Jimerson
Sayville, New York
(December 28, 2006)

Bernard Katz
Syosset, New York
(December 5, 2006)

Stuart Neal Kingoff
Monsey, New York
(December 28, 2006)

John Lewis McArdle Jr.
Austin, Texas
(December 6, 2006, to December 20, 2006)

John Patrick Murley
Weatherford, Texas
(December 6, 2006)

Allan Carlyle Murray
Brooklyn, New York
(December 20, 2006)

Samuel Edward Parsons
Rogersville, Missouri
(December 27, 2006)

William Jeffrey Reagan
Seaford, Virginia
(December 13, 2006)

John C. Rose
Copigogue, Wyoming
(December 28, 2006)

John Patrick Sullivan Jr.
Boston, Massachusetts
(December 28, 2006)

David John Williams III
Miami, Florida
(December 7, 2006)

Raymond C. Wu
Arcadia, California
(December 27, 2006)

NASD Fines Jefferies & Company \$5.5 Million for Providing Improper Gifts and Excessive Entertainment to Fidelity Traders

Former Jefferies Trader Kevin Quinn Barred, Supervisor Suspended and Fined

NASD has fined Jefferies & Company, Inc., of New York, \$5.5 million for providing more than \$1.6 million in improper gifts and entertainment to equity traders employed by FMR Co., Inc., an investment advisor to the Fidelity family of mutual funds, between Sept. 3, 2002, and Oct. 11, 2004. The improper gifts to those Fidelity traders exceeded \$600,000 and included private chartered air travel, non-promotional sports-related merchandise and expensive bottles of wine. The impermissible entertainment totaled more than \$1 million and included lavish trips, private chartered flights, expensive hotel accommodations, weekend golf outings and tickets to the 2004 Super Bowl.

NASD also permanently barred former Jefferies trader Kevin Quinn from associating with any NASD-registered firm in any capacity. In addition, it fined Scott W. Jones, Quinn's former supervisor, \$50,000 and suspended him for three months from associating with any NASD-registered firm in a supervisory capacity. Jones is also prohibited from supervising business entertainment, gifts or travel for the next two years. NASD also ordered Jefferies to retain an independent consultant to conduct a comprehensive review of the firm's policies, procedures and training relating to gifts and entertainment, and to adopt recommended improvements.

"The value of improper gifts and entertainment in this case is unprecedented," said James S. Shorris, NASD Executive Vice President and Head of Enforcement. "NASD's gift and gratuity rules were designed to prevent just the sort of conduct at issue here, which threatens the integrity of the relationship between a brokerage firm and its institutional customer. That this customer—a mutual fund manager—was itself a fiduciary only aggravates the already egregious circumstances in this case."

NASD found that in 2002, Jefferies hired Quinn as an institutional sales trader in its Equity Division and agreed to pay him an annual base salary of \$4 million in 2002 and 2003, and \$4.75 million in 2004. The firm also provided Quinn with an annual travel and entertainment budget of \$1.5 million to be used by Quinn and his team to entertain Fidelity traders to obtain order flow for the Jefferies Equity Division. Jefferies routinely and repeatedly reimbursed Quinn for gifts prohibited by NASD rules, which Quinn provided to Fidelity traders. NASD rules limit the value of gifts that firms and associated persons may give to customers of the firm—such as Fidelity and its traders—to \$100 per individual recipient per year. Examples of the types of gifts Jefferies, acting through Quinn, provided to Fidelity traders include:

- To one Fidelity trader, in 2002, a private chartered flight from Bedford, MA, to Bermuda at a cost exceeding \$17,000; in 2003, private chartered flights from Boston to Los Angeles and Florida, at a cost exceeding \$70,000 and \$31,000, respectively; and in 2004, golf clubs, for which Quinn paid more than \$500, and a private chartered flight from Bedford, MA, to Puerto Rico at a cost exceeding \$23,000.
- To another Fidelity trader, in 2002, tickets to the Wimbledon tennis tournament at a cost exceeding \$19,000, and eight bottles of wine at a cost of \$5,900; in 2003, tickets to the men's and women's Wimbledon tennis finals at a cost exceeding \$31,000, tickets to a Justin Timberlake/Christina Aguilera concert at a cost of \$1,200, tickets to the U.S. Open tennis tournament at a cost exceeding \$7,000 and 12 bottles of 1993 Chateau Petrus (Pomerol) wine at a cost exceeding \$7,500; and, in 2004, tickets to Wimbledon and hotel accommodations for the event at the Lanesborough Hotel in London, for which Quinn paid more than \$38,000 and \$12,000, respectively.
- To a third Fidelity trader, in 2002, a portable DVD player at a cost of approximately \$1,000; in 2003, six bottles of 1998 Opus One wine, at a cost exceeding \$2,600; and, in 2004, a private chartered flight from Bedford, MA, to Providenciales, Turks and Caicos Islands, at a cost exceeding \$47,000.

Quinn did not accompany any Fidelity trader on any of the gifted flights or to any of the events identified as a gift.

NASD also found that Jefferies, acting through Jones, routinely approved and reimbursed Quinn for entertainment that was inappropriate, excessive and that raised an issue of propriety. During the period Jefferies employed Quinn, it reimbursed Quinn for more than \$1 million for expenses he incurred while entertaining Fidelity traders. Examples of that entertainment include:

- In 2002, Quinn entertained several Fidelity traders by treating them to a four-day golf outing in various locations on the West Coast (the "Fall Classic"), including Las Vegas, and Cabo San Lucas, Mexico. Quinn paid more than \$225,000 for, among other things, private air charter flights between each destination and lodging for his guests, including as much as \$5,000 per night, per bungalow at the Bellagio Hotel in Las Vegas, and a similar amount for each of two villas he used at the Esperanza Resort in Cabo San Lucas. In 2003, Quinn again used the Fall Classic to entertain Fidelity traders at a cost exceeding \$140,000. Quinn flew his guests to Las Vegas and Scottsdale, AZ, by private air charter and paid for their lavish hotel accommodations.
- In 2003 and 2004, Quinn entertained one Fidelity trader by treating the trader and his family to a one-week vacation in Florida with Quinn and his family, for which Jefferies reimbursed Quinn more than \$93,000 and \$64,000, respectively. For each of the vacations, Quinn provided the Fidelity trader and his family with a roundtrip private charter flight between Florida and Massachusetts, as well as costly lodging, meals and various additional resort expenses at the Breakers Hotel in Palm Beach, Florida.
- In 2003, in connection with a bachelor party in Miami for a Fidelity trader, Quinn paid more than \$75,000 for a limousine service and private roundtrip chartered flights between Boston and Miami for several Fidelity traders, including the bachelor and other guests.

- In 2004, Quinn invited several Fidelity traders to join Quinn and another Jefferies trader at the Super Bowl in Houston, where Quinn paid more than \$125,000 for Super Bowl weekend-related expenses for the group. Weekend expenses included Maxim and Playboy pre-game parties, a car service, private round-trip chartered flights, lodging and tickets to the game.

NASD further found that despite the exceptional annual travel and expense allowance it gave Quinn, Jefferies failed to establish and maintain an adequate supervisory system, including adequate written supervisory procedures, to ensure reasonably that Quinn did not use the budget in violation of NASD rules. Moreover, Jefferies, acting through Jones, failed to supervise reasonably Quinn's use of the travel and expense budget.

Jefferies, Quinn and Jones settled the actions without admitting or denying the allegations, but consented to the entry of NASD's findings.

NASD Fines Four Firms for Supervisory Failures Relating to Mutual Fund Sales Charge Waivers

Edward Jones, RBC Dain Rauscher, Royal Alliance, and Morgan Stanley to Pay an Estimated \$43.8 Million in Remediation to Customers; Morgan Stanley Credited For Taking Remedial Measures

NASD has imposed fines totaling \$850,000 against four firms—Edward D. Jones & Co., L.P. of St. Louis (\$250,000), RBC Dain Rauscher Inc. of Minneapolis (\$250,000), Royal Alliance Associates, Inc. of New York (\$250,000) and Morgan Stanley DW Inc. of New York (\$100,000)—for failing to have adequate supervisory systems and procedures to identify opportunities for investors to purchase Class A mutual fund shares at net asset value (NAV), or without a front-end sales charge.

Each firm was ordered to provide remediation to thousands of eligible clients who qualified for, but did not receive, the benefit of available NAV transfer programs. Based on estimates provided by each firm, Edward Jones will pay \$25 million, plus interest; RBC Dain Rauscher will pay \$6.8 million, plus interest; Royal Alliance will pay \$1.6 million, plus interest; and Morgan

Stanley will pay \$10.4 million, plus interest. Each firm is required to retain a third-party examiner to oversee the remediation process.

“The failures on the part of Edward Jones, RBC Dain Rauscher, Royal Alliance, and Morgan Stanley to adequately supervise the identification and implementation of NAV transfer programs deprived their customers of substantial discounts on mutual fund purchases,” said James S. Shorris, NASD Executive Vice President and Head of Enforcement. “Securities firms must learn all of the relevant pricing features of the fund shares they sell and ensure that eligible investors receive all available discounts and sales charge waivers, without exception.”

During 2002 - 2004, many mutual fund families offered NAV transfer programs that eliminated front-end mutual fund sales charges for certain customers. Under an NAV transfer program, customers who redeem fund shares for which they paid a sales charge are permitted to use those proceeds within prescribed time periods to purchase Class A shares of a new mutual fund at NAV—that is, without paying another sales charge.

NASD found that each firm during the relevant period failed to have systems reasonably designed to ensure that customers received NAV pricing when appropriate. As a result, certain investors purchased Class A shares and incurred front-end sales charges that they should not have paid, or purchased other mutual fund share classes that subjected them to higher fees and the potential of contingent deferred, or back-end, sales charges.

In sanctioning Morgan Stanley, NASD considered the firm’s prompt and comprehensive remedial actions. Subsequent to the commencement of NASD’s investigation, Morgan Stanley promptly assessed the extent of customer harm and began the process of identifying investors to make restitution. The firm’s remediation program included a review of purchases in 2001 as well as purchases during 2002 through January 2005.

In settling these matters, each firm neither admitted nor denied the charges, but consented to the entry of NASD’s findings.

NASD Fines USAllianz Securities \$5 Million for Widespread Supervisory, Recordkeeping Violations

Firm Also Precluded from Opening Any New Offices for 30 Days and from Hiring Any New Registered Representatives for 7 Days

NASD has fined USAllianz Securities \$5 million for widespread deficiencies in its supervisory system and for recordkeeping violations. As part of the settlement, USAllianz Securities may not open a new office for 30 calendar days, and may not hire new registered representatives for seven days.

USAllianz was also ordered to retain an independent consultant to verify that it has fully implemented recommended modifications and additions to its supervisory system and procedures.

NASD found that for almost five years, USAllianz failed to establish and maintain a reasonable supervisory system and written procedures designed to oversee the firm’s registered representatives and their activities. Resulting deficiencies included, among other things:

- Supervising principals who, in some instances, did not know which registered representatives they were responsible for supervising and in other instances registered representatives could not identify their supervising principals, both resulting in supervisory lapses.
- Supervisors who were not qualified to carry out their supervisory responsibilities because they lacked experience, education and training; and, in other instances, supervisory principals inappropriately delegating their day-to-day supervisory responsibilities to other, less experienced principals, often without notifying the firm.
- Inadequate staffing resources dedicated to compliance given the size and location of the firm’s sales force.
- An internal office inspection program that failed to provide adequate oversight, training and guidance, leading to substantial failures to properly identify deficiencies.

On Oct. 12, 2006, following the period of the conduct found by NASD, USAllianz was integrated with and assumed the name of Questar Capital Corporation.

“The severity of the sanctions in this case reflects the magnitude of USAllianz’s supervisory failures,” said James S. Shorris, NASD Executive Vice President and Head of Enforcement. “Firms must ensure that they have adequate systems in place, and well-trained and qualified supervisors, to conduct meaningful supervision of their sales staff. The failures of supervision at USAllianz’s individual offices were compounded by its wholly inadequate internal inspection program.”

Specifically, NASD found that from April 2001 through March 2006, USAllianz did not have an adequate system in place to ensure that principals with supervisory responsibilities knew which registered representatives they were responsible for supervising. Further, some representatives could not identify their supervising principal. As a result, for certain representatives, activities commonly associated with daily supervision such as trade blotter and correspondence review did not take place. During that period, the number of Allianz representatives ranged from as many as 3,000 to between 800 and 900.

NASD also found that many supervisors were not qualified to carry out their supervisory responsibilities because of a lack of experience, education and training. Further, some supervisory principals delegated their day-to-day responsibilities to other, less experienced principals, often without notifying the firm. In one particular office, a principal with supervisory responsibilities for about 150 registered representatives delegated supervisory responsibilities to an individual who had no principal training and no previous experience as a supervisor, and failed to conduct appropriate follow-up.

NASD also found that USAllianz’s compliance department was understaffed. For much of 2001 and 2002, it had just two compliance officers for a large field sales force that were working in numerous offices scattered throughout the United States. Although the size of the firm’s sales force declined in 2004, the firm was still inadequately staffed with only four compliance officers.

Additionally, NASD found that USAllianz failed to provide adequate oversight, training and guidance in its internal office inspection program. USAllianz did not provide inspectors with any objective standards for finding deficiencies or potential rule violations, which led to numerous instances where deficiencies were not appropriately identified. For instance, an inspector could determine that an entire office was fully compliant in an area simply because a single registered representative did not exhibit any deficiencies in that area. The firm failed to offer an adequate training program for inspectors and did not ensure that they had an appropriate level of experience before conducting inspections. For example, one inspector who conducted a 2004 audit of a USAllianz office had no training in how to conduct inspections or in securities compliance generally. This person had previously worked for USAllianz in a clerical position. NASD also found that, generally, USAllianz’s inspection program failed to properly identify deficiencies and was not carried out in a timely manner.

Finally, prior to March 2005, USAllianz did not have any system in place to capture, preserve and maintain email communications. The firm implemented an interim system in March 2005, but that system was not successful. The firm did not have an effective system in place to capture and retain all emails to and from its sales force until mid-December 2005.

In settling with NASD, USAllianz neither admitted nor denied the findings, but consented to NASD’s findings.

NASD Charges Morgan Stanley DW with Repeatedly Failing to Provide Emails to Arbitration Claimants and Regulators

Firm Also Charged with Falsely Claiming that Millions of Emails in its Possession Had Been Lost in 9-11 Terrorist Attacks

NASD has charged Morgan Stanley DW, Inc. with routinely failing to provide emails to claimants in arbitration proceedings as well as to regulators—and with falsely claiming that millions of emails it possessed had been lost in the Sept. 11, 2001, terrorist attacks on the World Trade Center in New York, where its email servers were housed.

In its complaint, NASD alleges that Morgan Stanley failed to provide pre-September 11 emails to arbitration claimants and regulators in numerous proceedings from October 2001 through March 2005. NASD also charged that Morgan Stanley falsely claimed in many of those proceedings that such email had been destroyed. In fact, according to the complaint, Morgan Stanley possessed millions of pre-September 11 emails that had been restored to its system shortly after September 11 using back-up tapes. Many other emails were maintained on individual users' computers and were therefore never affected by the attacks, yet Morgan Stanley often failed to search those computers when responding to requests.

NASD also charged that Morgan Stanley later destroyed many of the emails it did possess, in two ways—by overwriting backup tapes that had been used to restore the emails to the firm's system and by allowing users of the firm's email system to permanently delete the emails over an extended period of time. As a result, the complaint alleges that between September 2001 and March 2005, millions of the emails were destroyed.

"It is essential that firms comply with discovery obligations in arbitration proceedings and respond fully and truthfully to regulatory requests," said James S. Shorris, NASD Executive Vice President and Head of Enforcement. "In this case, we charge that Morgan Stanley's conduct fell far below those standards, with the firm repeatedly making false statements about the existence of important evidence, and failing to provide that evidence in numerous proceedings. The firm's actions undermined the integrity of the regulatory and arbitration processes potentially leaving in question the validity of the outcomes in hundreds of cases."

NASD's complaint charges Morgan Stanley with violating NASD rules by failing to produce email in its possession in numerous customer arbitration proceedings over the three-and-a-half year period, and by making misrepresentations that it did not have such email in numerous proceedings. The complaint also charges Morgan Stanley with violating NASD rules by failing to produce the email to a number of regulators, including NASD, and by falsely representing that the email had been destroyed. For instance, NASD charged that in an NASD investigation into the firm's fee-based brokerage practices, Morgan Stanley falsely claimed that it did not have pre-October 2001 email and failed to produce over 12,000 emails and attachments in response to an NASD request. By the time the firm conducted the search that led to the production of these emails, the firm had already deleted millions of other emails from its servers and the regulatory matter at issue had been settled (see the August 2005 NASD news release *NASD Orders Morgan Stanley to Pay Over \$6.1 Million for Fee-Based Account Violations; Firm's Customers to Receive \$4.6 Million in Restitution*).

NASD also charged that Morgan Stanley violated recordkeeping rules by destroying many of the emails it did possess, failed to implement procedures providing for the retention of email, and failed to adopt adequate procedures governing searches for email in response to requests by regulators and in arbitration proceedings.

FBR to Pay Regulators \$7.7 Million to Resolve Charges Related to Improper Short Selling of Compudyne PIPE Shares

Former FBR Chairman Emanuel Friedman Suspended as Supervisor, Fined \$1.2 Million, Former Chief Compliance Officer Censured, Fined \$110,000

Friedman, Billings, Ramsey & Co., Inc. (FBR), an investment banking and brokerage firm based in Arlington, VA, has agreed to pay more than \$7.7 million to NASD and the Securities and Exchange Commission (SEC) to resolve charges arising from FBR's improper trading in shares of Compudyne Corporation, in a PIPE deal it structured and managed for the Maryland-based security firm. The action is the fourth enforcement action NASD has taken arising from the Compudyne PIPE deal.

NASD imposed a fine of \$4 million on FBR. In a separate settlement with the SEC, FBR agreed to pay more than \$3.7 million in civil penalties, disgorgement and interest. FBR also agreed to hire an independent consultant acceptable to NASD and the SEC to review its procedures for safeguarding material, nonpublic information.

FBR's former chairman, Emanuel Friedman, and its former Chief Compliance Officer, Nicholas J. Nichols, also entered into settlement agreements with NASD and the SEC. NASD fined Friedman \$500,000 and suspended him from acting in a supervisory capacity with any NASD-registered firm for two years. Friedman will pay a civil penalty of more than \$750,000 to the SEC. Nichols will pay a \$50,000 fine to NASD and a civil penalty of \$60,000 to the SEC.

"This settlement furthers NASD's efforts to prevent and deter abuses in the rapidly-growing market for PIPEs," said Cameron K. Funkhouser, Senior Vice President of NASD's Department of Market Regulation.

A PIPE (Private Investment in a Public Equity) is a private offering in which accredited investors agree to purchase restricted, unregistered securities of public companies. Only after the PIPE shares registration is approved by the SEC are investors free to sell them on the open market. PIPE shares can only be offered to "accredited" investors—investors with assets of \$1 million or more.

NASD found that in September 2001, Compudyne Corporation and FBR, its placement agent, offered accredited investors—on a confidential basis—a PIPE deal proposing to sell 2.45 million shares of common stock, which raised more than \$29 million. The restricted stock was offered at the below-market price of \$12 per share. NASD found that FBR failed to maintain an information barrier to prevent trading by FBR personnel who were aware of this information.

As part of efforts to make a market in Compudyne, supply liquidity, and advertise FBR's capabilities, FBR's head trader, who was aware of material, nonpublic information about the PIPE, engaged in trading in Compudyne before the PIPE was announced to the public. By the time the PIPE was announced on Oct. 9, 2001, FBR had a net short position of approximately 179,495 shares.

FBR eventually covered its short position by buying shares of Compudyne after the shares that had been purchased in the private placement were registered and became tradable in the market. FBR made a profit of approximately \$343,773 on the short sales of Compudyne that were executed before the public announcement of the PIPE.

NASD also found that FBR failed to enforce its written supervisory procedures designed to protect confidential information, failed properly to locate stock to borrow in order to sell Compudyne shares short, and misinformed NASD about the departure from the firm of a broker involved in selling the Compudyne PIPE.

In settling this matter with NASD, FBR, Friedman and Nichols neither admitted nor denied the charges, but consented to the entry of NASD's findings. In the SEC proceeding, FBR, Friedman and Nichols consented to the entry of a final judgment by the U.S. District Court, and FBR and Friedman consented to an SEC administrative order, without admitting or denying the allegations in the SEC's complaint.