

JUNE 2007

# Notices to Members

## Notices

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# Notice to Members

JUNE 2007

## SUGGESTED ROUTING

Corporate Financing  
Executive Representatives  
Legal & Compliance  
Senior Management  
Operations

## KEY TOPICS

Affiliates  
Control Entity  
Institutional Accounts  
Member Private Offerings  
Private Placements  
Private Placement Memorandum  
Regulation D

## REQUEST FOR COMMENT

### Member Private Offerings

NASD Requests Comment on Proposed Rule 2721 to Regulate Member Private Securities Offerings; **Comment Period Expires July 20, 2007**

#### Executive Summary

NASD is issuing this *Notice to Members* to solicit comments from members and other interested parties on proposed Rule 2721 pertaining to private placements of unregistered securities issued by a member (Member Private Offerings or MPOs), which would require that:

- ▶ a private placement memorandum (PPM) be provided to each investor with information regarding risk factors, intended use of proceeds, offering expenses and any other information necessary to ensure that required information is not misleading;
- ▶ the PPM be filed with NASD's Corporate Financing Department at or prior to the time it is provided to any investor; and
- ▶ at least 85 percent of the offering proceeds be used for the business purposes identified under the "use of proceeds" disclosure in the PPM.

Rule 2721 is proposed in response to problems NASD has identified in connection with the private offerings of members' securities or those of a control entity. The proposed Rule also contains several exemptions for offerings to certain types of institutional investors, offerings under various provisions of the federal securities laws for which NASD believes the protections of the proposed rule are not necessary, and offerings in which investors otherwise would be expected to have access to sufficient information about the issuer.

07-27

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## Action Requested

NASD encourages all interested parties to comment on the proposal. Comments must be received by July 20, 2007. Members and other interested parties can submit their comments through the following methods:

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

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

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

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

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

## Questions/Further Information

As noted above, hard copy comments should be mailed to Barbara Z. Sweeney. Questions concerning this *Notice* may be directed to Thomas M. Selman, Executive Vice President, Investment Companies/Corporate Financing, at (240) 386-4533; Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8104; or Joseph E. Price, Vice President, Corporate Financing, at (240) 386-4623.

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## Background and Discussion

In recent years, NASD has brought numerous enforcement cases concerning abuses in connection with Member Private Offerings.<sup>3</sup> In addition, NASD conducted a sweep of firms that had engaged in MPOs and found widespread problems. Allegations in these cases include the failure to provide PPMs to investors, as well as misleading, incorrect or selective disclosure in PPMs that were provided, including omissions and misrepresentations regarding selling compensation and the use of offering proceeds.<sup>4</sup>

Typically, MPOs are private placements that rely on the SEC Regulation D exemption from the registration and disclosure requirements in the Securities Act of 1933 (Securities Act).<sup>5</sup> Inasmuch as MPOs are *private* placements, they are not subject to the existing NASD rules governing underwriting terms and arrangements in *public* offerings and conflicts of interest by members that participate in *public* offerings.<sup>6</sup>

### 1. Proposed Rule 2721

#### A. Offerings by Members or a Control Entity

Proposed Rule 2721 (set forth in Attachment A) would establish disclosure and filing requirements and limits on offering expenses for private placements by members of their own securities or those of a “control entity.” A “control entity” for purposes of the proposed rule would be defined as an entity that controls, is controlled by or is under common control with a member or its associated persons. The term “control” for purposes of the proposed rule would be determined based on beneficial ownership of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership.<sup>7</sup> The power to direct the management or policies of a corporation or partnership alone (e.g., a general partner)—absent meeting the majority ownership or right to the majority of profits—would not constitute “control” for the control entity definition in the proposed rule.

#### B. Disclosure Requirements

Proposed Rule 2721 would require members to provide each investor in an MPO (whether accredited or unaccredited) by a member or a control affiliate with a PPM that contains the following information:

- ◆ risk factors associated with the investment, including company risks, industry risks and market risks;
- ◆ intended use of offering proceeds;
- ◆ offering expenses and selling compensation; and
- ◆ any other information necessary to ensure that the required information is not misleading.

This requirement would help ensure that every investor in an MPO by a member or a control entity receives basic information concerning the nature of the offering.

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### C. Filing Requirements

The proposed rule also would require members to file the PPM with NASD at or prior to the first time the PPM is provided to any investor. In addition, any amendment or exhibit to the PPM would be required to be filed with NASD within ten days of being provided to any investor. However, unlike filings with NASD under Rules 2710, 2720 and 2810, a member could begin offering MPO securities immediately after filing the PPM.<sup>8</sup>

### D. Use of Offering Proceeds

Proposed Rule 2721 would require that at least 85 percent of the offering proceeds of an MPO be used for the business purposes identified in the PPM. This condition is in response to abuses we have seen where substantial amounts of offering proceeds have been dedicated to purposes other than the business purpose identified in the PPM, including selling compensation and related party benefits.<sup>9</sup> Consequently, under the proposed rule, offering and other expenses of the MPO could not exceed 15 percent of the offering proceeds. This figure is consistent with the limitation of offering fees and expenses, including compensation, in NASD Rule 2810 (Direct Participation Programs), and the North American Securities Administrators Association (NASAA) guidelines with respect to public offerings subject to state regulation. When a member engages in a private placement of its own securities or those of a control entity, investors should be assured that, at a minimum, 85 percent of the proceeds of the offering are dedicated to the business purposes described in the PPM. We request comment on whether this threshold is appropriate.

### E. Proposed Exemptions

Proposed Rule 2721 would include several exemptions. Specifically, the proposed Rule would exempt MPOs sold solely to:

- ◆ institutional accounts (as defined in NASD Rule 3110(c)(4));
- ◆ qualified purchasers (as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940);
- ◆ qualified institutional buyers (as defined in SEC Rule 144A of the Securities Act);
- ◆ investment companies (as defined in Rule SEC Rule 144A);
- ◆ an entity composed exclusively of qualified institutional buyers (as defined in SEC Rule 144A); and
- ◆ banks (as defined in SEC Rule 144A).

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In addition, the following types of offerings would be exempt from the proposed rule:

- ◆ offerings made pursuant to SEC Rule 144A or SEC Regulation S;
- ◆ offerings in which a member acts solely in a wholesaling capacity and sells unregistered securities to other unaffiliated broker-dealers;
- ◆ offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act; and
- ◆ offerings of subordinated loans under SEC Rule 15c3-1, Appendix D.

Finally, the proposed rule also would exempt MPOs in which investors would be expected to have access to sufficient information about the issuer and its securities in addition to the information provided by the member conducting the MPO. These include exemptions for:

- ◆ offerings of unregistered investment grade rated debt;
- ◆ offerings to employees and affiliates of the issuer; and
- ◆ offerings of securities issued in stock splits and restructuring transactions.

#### F. Scope of Proposed Rule 2721

Proposed Rule 2721 is intended to provide investor protections with respect to private offerings by a member that are parallel, but not identical, to the protections provided by Rule 2720 with respect to a member's public offerings.<sup>10</sup> Therefore, Rule 2721, like Rule 2720, would apply only to private placements by a member or its control entities. The proposed rule would apply to offerings by an entity that is under common control with the member, or that the member firm or its associated persons control. For purposes of proposed Rule 2721, "control" is defined as beneficial ownership of more than 50 percent of the outstanding voting securities if the entity is a corporation, or in the case of a partnership, more than a 50 percent interest in its distributable profits or losses.<sup>11</sup>

Consequently, proposed Rule 2721 would not apply to private placements by any entity that does not meet this control test, including investment partnerships, direct participation programs, and other private funds that the member might organize but in which the member, its associated persons, or any parent of the member does not beneficially own the requisite ownership position. NASD requests comment on whether the proposed rule should apply to these other entities.

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## Endnotes

- 1 See *Notice to Members 03-73* (November 2003) (NASD Announces Online Availability of Comments). Personal identifying information, such as names or email addresses, will not be edited from submissions. Submit only information you wish to make publicly available.
- 2 Section 19 of the Securities Exchange Act of 1934 (Exchange Act) permits certain limited types of proposed rule changes to take effect upon filing with the SEC. The SEC has the authority to summarily abrogate these types of rule changes within 60 days of filing. See Exchange Act Section 19 and the rules thereunder.
- 3 *E.g., Franklin Ross, Inc.*, NASD No. E072004001501 (settled April 2006), summarized in *NASD NTM Disciplinary Actions*, p. 1 (May 2006); *Capital Growth Financial, LLC*, NASD No. E072003099001 (settled February 2006), summarized in *NASD NTM Disciplinary Actions*, p. 1 (April 2006); *Craig & Associates*, NASD No. E3B2003026801 (settled August 2005), summarized in *NASD NTM Disciplinary Actions*, p. D6 (October 2005); *Online Brokerage Services, Inc.*, NASD No. C8A050021 (settled March 2005), summarized in *NASD NTM Disciplinary Actions*, p. D5 (May 2005); *IAR Securities/Legend Merchant Group*, NASD No. C10030058 (settled July 2004), summarized in *NASD NTM Disciplinary Actions*, p. D1 (July 2004); *Shelman Securities Corp.*, NASD No. C06030013 (settled December 2003), summarized in *NASD NTM Disciplinary Actions*, p. D1 (February 2004); *Neil Brooks*, NASD No. C06030009 (settled June 2003), summarized in NASD Press Release, NASD Files Three Enforcement Actions for Fraudulent Hedge Fund Offerings (August 18, 2003); *Dep't of Enforcement v. L.H. Ross & Co., Inc.*, Complaint No. CAF040056 (Hearing Panel decision January 15, 2005); *Dep't of Enforcement v. Win Capital Corp.*, Complaint No. CLI030013 (Hearing Panel decision August 6, 2004). In addition to these cases, NASD has numerous ongoing investigations involving MPOs.
- 4 SEC Regulation D does not require disclosure documents to be prepared or provided in offerings made solely to accredited investors. However, in some MPOs, NASD found that no PPM was prepared even though sales were made to persons who are not accredited investors. In others, a PPM was prepared, but it was not provided to certain investors, including those that were unaccredited.
- 5 In 1982, the SEC adopted Regulation D as a safe harbor from the registration requirements of the Securities Act. NASD members and their control entities raise capital under Regulation D in MPOs to finance their operations or to pool customer funds to create investment vehicles that provide revenue to the members. MPOs also can be offered privately pursuant to other available exemptions from registration under the Securities Act, such as Section 4(2).
- 6 NASD Conduct Rules 2710, 2720 and 2810 only govern member participation in *public* offerings of securities.
- 7 For purposes of quantifying the percent of profits or losses in a partnership attributable to the general partner, NASD will not include performance and management fees earned by the general partner. However, if such performance and management fees are subsequently re-invested in the partnership, thereby increasing the general partner's ownership interest, then such interests would be considered in determining whether the partnership is a control entity.
- 8 NASD would not issue a "no objections opinion." However, if NASD subsequently determined that disclosures in the PPM appeared to be incomplete, inaccurate or misleading, NASD could make further inquiries. The filing requirement also could facilitate the creation of a database on MPO activity that would be used in connection with the member examination process.

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- 9 The MPO sweep revealed that in some cases, offering proceeds were used for individual bonuses, sales contest awards, commissions in excess of 20 percent, or other undisclosed compensation.
- 10 Members would remain subject to other NASD rules that govern a member's participation in the offer and sale of a security, including Rules 2110, 2120 and Rule 2310. Members also are subject to the anti-fraud provisions of the Securities Act, including Sections 10(b), 11, 12 and 17.
- 11 Rule 2720 presumes control when there is beneficial ownership of 10 percent of an entity's outstanding voting securities if the entity is a corporation, or in the case of a partnership, more than a 10 percent interest in its distributable profits or losses. See Rule 2720(b)(1)(B).

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## **ATTACHMENT A**

Proposed Rule Text

### **2721. Private Placements of Securities Issued by Members**

#### **(a) Definitions**

##### **(1) Member Private Offering or MPO**

A private placement of unregistered securities issued by a member or a control entity in a transaction exempt from registration under the Securities Act and the filing requirements under Rules 2710, 2720 and 2810.

##### **(2) Control Entity**

Any entity that controls or is under common control with a member, or that is controlled by a member or its associated persons. The term "control" for purposes of this Rule means beneficial ownership of more than 50 percent of the outstanding voting securities of a corporation, or the right to more than 50 percent of the distributable profits or losses of a partnership.

#### **(b) Filing Requirements**

No member or associated person may offer or sell any security in a Member Private Offering unless the private placement memorandum has been filed with the Corporate Financing Department at or prior to the first time the private placement memorandum is provided to any investor. An amendment or exhibit to the private placement memorandum also must be filed with the Corporate Financing Department within ten days of being provided to any investor.

#### **(c) Disclosure Requirements**

No member or associated person may participate in a Member Private Offering unless a private placement memorandum is provided to each investor and the private placement memorandum discloses:

- (1) risk factors associated with the investment, including company risks, industry risks and market risks;
- (2) intended use of the offering proceeds;
- (3) offering expenses and the amount of selling compensation that will be paid to the member and its associated persons; and
- (4) any other information necessary to ensure that required information is not misleading.

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**(d) Use of Offering Proceeds**

At least 85 percent of the offering proceeds raised in a Member Private Offering must be used for the business purpose identified in the “intended use of the offering proceeds” disclosure in the private placement memorandum.

**(e) Exemptions**

The following Member Private Offerings are exempt from the requirements of this Rule:

- (1) offerings sold solely to:
  - (A) institutional accounts (as defined in NASD Rule 3110(c)(4));
  - (B) qualified purchasers (as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940);
  - (C) qualified institutional buyers (as defined in SEC Rule 144A);
  - (D) investment companies (as defined in Rule SEC Rule 144A);
  - (E) an entity composed exclusively of qualified institutional buyers (as defined in SEC Rule 144A); and
  - (F) banks (as defined in SEC Rule 144A).
- (2) offerings made pursuant to SEC Rule 144A or SEC Regulation S;
- (3) offerings in which a member acts solely in a wholesaling capacity and sells unregistered securities to other unaffiliated broker-dealers;
- (4) offerings of exempt securities with short term maturities under Section 3(a)(3) of the Securities Act;
- (5) offerings of subordinated loans under SEC Rule 15c3-1, Appendix D;
- (6) offerings of unregistered investment grade rated debt;
- (7) offerings to employees and affiliates of the issuer; and
- (8) offerings of securities issued in stock splits and restructuring transactions.

**(f) Application for Exemption**

Pursuant to the Rule 9600 Series, NASD may exempt a member or person associated with a member from the provisions of this Rule for good cause shown.

# Notice to Members

JUNE 2007

## SUGGESTED ROUTING

Fixed Income  
Trading and Market Making  
Sales  
Senior Management  
Legal and Compliance  
Internal Audit  
Training

## KEY TOPICS

Mark-Ups  
Debt Securities  
Rule 2440  
Pricing of Debt Securities

## GUIDANCE

### Mark-Ups on Debt Securities

SEC Approves Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities; **Effective Date: July 5, 2007**

#### Executive Summary

On April 16, 2007, the Securities and Exchange Commission (SEC) approved IM-2440-2, "Additional Mark-Up Policy for Transactions in Debt Securities, Except Municipal Securities" (Debt Mark-Up Interpretation or Interpretation), and renumbered IM-2440 as IM-2440-1.<sup>1</sup> The Debt Mark-Up Interpretation supplements Rule 2440, "Fair Prices and Commissions," which requires broker-dealers to charge customers fair mark-ups and commissions, and IM-2440-1, "Mark-Ups."

In a debt security transaction with a customer, the broker-dealer's mark-up (mark-down) must be calculated from the prevailing market price of that security. The new Debt Mark-Up Interpretation states that, presumptively, the prevailing market price of a debt security is the broker-dealer's contemporaneous cost (or, in a sale, the broker-dealer's contemporaneous proceeds).

The Interpretation also addresses the procedures for determining prevailing market price (as a price other than contemporaneous cost) when a broker-dealer has the discretion, under the Interpretation, not to use its contemporaneous cost as the measure. In addition, the Interpretation includes an exemption for transactions in non-investment grade debt securities between broker-dealers and qualified institutional buyers (QIBs), as defined in Rule 144A under the Securities Act of 1933 (Securities Act) (QIB Exemption).<sup>2</sup> The Interpretation and the amendment to IM-2440 are set forth in Attachment A of this *Notice*.

The Interpretation and the amendment to IM-2440 become effective July 5, 2007.

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## Questions/Further Information

Questions regarding this *Notice* may be directed to Sharon K. Zackula, Associate Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985; Malcolm P. Northam, Director, Fixed Income Securities Regulation, Regulation Policy, Member Regulation, at (202) 728-8085; and the Legal Section, Market Regulation, at (240) 386-5126.

## Background

Generally, under NASD Rule 2440 and IM-2440-1, broker-dealers may not charge compensation for the execution of customer transactions, whether in the form of a mark-up (mark-down) or commission, that is unfair, unreasonable or excessive. Unfair, unreasonable or excessive compensation for customer trades also violates Rule 2110, which requires broker-dealers to conduct their business in accordance with just and equitable principles of trade.<sup>3</sup> The Debt Mark-Up Interpretation approved on April 16, 2007, supplements Rule 2440 and IM-2440-1.<sup>4</sup>

Rule 2440, IM-2440-1 and the Interpretation apply to transactions in debt securities between a broker-dealer and a customer except transactions in municipal securities, as defined in Section 3(a)(29) of the Securities Exchange Act of 1934 (Act),<sup>5</sup> and exempted securities (other than municipal securities), as defined in Section 3(a)(12) of the Act.<sup>6</sup>

## Prevailing Market Price

In a debt security transaction with a customer, the broker-dealer's mark-up (mark-down) must be calculated from the prevailing market price of that security. The Debt Mark-Up Interpretation focuses particularly on the key issue of the proper identification of the prevailing market price. The Interpretation states that, presumptively, the prevailing market price of a debt security is the broker-dealer's contemporaneous cost (or, in a sale, the broker-dealer's contemporaneous proceeds).<sup>7</sup> The Interpretation also addresses the procedures for determining prevailing market price (as a price other than contemporaneous cost) when a broker-dealer, under the Interpretation, may choose not to use its contemporaneous cost as the measure of the prevailing market price. This occurs when there is no contemporaneous cost (proceeds) or certain events have occurred, as discussed on the next page.

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### **Contemporaneous Cost**

A broker-dealer may seek to overcome the presumption that its contemporaneous cost (proceeds) is indicative of the prevailing market price in any of three events:

- (i) interest rates changed after the broker-dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing;
- (ii) the credit quality of the debt security changed significantly after the broker-dealer's contemporaneous transaction; or
- (iii) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the broker-dealer's contemporaneous transaction.<sup>8</sup>

### **Pricing Alternatives to Contemporaneous Cost**

#### ***Hierarchy***

When the broker-dealer has no contemporaneous transaction, or any of the events set forth above have occurred, the Debt Mark-Up Interpretation identifies three factors that must be considered, in the order listed, to determine the prevailing market price (hierarchy pricing factors). As set out more fully in the Interpretation, the hierarchy pricing factors are as follows in the order of consideration: contemporaneous inter-dealer transactions in the same security; qualifying contemporaneous institutional account-dealer trades in the same security; or qualifying contemporaneous quotations.<sup>9</sup> The broker-dealer must determine that the relevant pricing information does not exist in each of the hierarchy pricing factors in their specified order before proceeding to any consideration of the next factor.

#### ***"Similar" Securities***

If none of the three hierarchy pricing factors are determinative of the relevant pricing information, the broker-dealer may then consider the pricing information from "similar" securities.<sup>10</sup> The Interpretation provides specific guidance about what constitutes "similar" securities for purposes of the Interpretation.<sup>11</sup> A broker-dealer should consider, among other things, credit quality of both securities, ratings, collateralization, spreads (over U.S. Treasury securities of similar duration) at which the securities are usually traded, general structural similarities (such as calls, maturity, embedded options), the size of the issue, float, recent turnover, and transferability or restrictions thereto.<sup>12</sup> Also, the Interpretation recognizes that there may not be "similar" securities for certain securities.<sup>13</sup> Generally, a "similar" security should be sufficiently equivalent to the subject security that it would serve as a reasonably fungible alternative investment. In addition, at a minimum, a broker-dealer must be able to fairly estimate the market yield for the subject security from the yields of "similar" securities.<sup>14</sup>

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The pricing factors incorporating “similar” securities are not hierarchal; that is, they may be considered in any order. However, when reviewing them, the broker-dealer must consider that the burden on the broker-dealer is the correct identification of the prevailing market price.<sup>15</sup>

### ***Economic Models***

Finally, where neither the hierarchy pricing factors nor similar securities can be used to establish the prevailing market price, the Debt Mark-Up Interpretation allows that the broker-dealer may use pricing information derived from an economic model to determine the prevailing market price of a debt security for purposes of a mark-up.<sup>16</sup>

An economic model used to identify prevailing market price must take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded option, coupon rate and face value, and all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods).<sup>17</sup>

### **The Qualified Institutional Buyer (QIB) Exemption**

The Interpretation contains a QIB Exemption, removing certain institutional customer transactions from the requirements of Rule 2440, IM-2440-1 and the Interpretation.<sup>18</sup> To rely upon the QIB Exemption, a broker-dealer must determine that:

- (i) the customer is a QIB as defined in Rule 144A under the Securities Act;
- (ii) the security that the QIB wishes to buy or sell is a non-investment grade debt security as defined for purposes of IM-2440-2; and
- (iii) after considering the factors set forth in IM-2310-3, which addresses institutional customer suitability factors, the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction to which the broker-dealer seeks to apply the exemption.<sup>19</sup>

If the broker-dealer establishes all three elements, then the QIB Exemption may be applied by the broker-dealer.

IM-2310-3 contains extensive factors to be considered in making the determination as to whether a QIB has the expertise to make an independent decision in respect of a transaction and in fact is making an independent decision. Therefore, members are advised to fully review this rule when applying the QIB exemption.

NASD is providing 30 days from publication of this *Notice* for implementation to provide members with adequate time to comply with the amended requirements. As such, the amendments become effective July 5, 2007.

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## Endnotes

- 1 See Securities Exchange Act Release No. 55638 (April 16, 2007), 77 FR 20150 (April 23, 2007) (File No. SR-NASD-2003-141) (approval order).

In this *Notice*, the term “mark-up” generally refers to both mark-ups and mark-downs, and the term “contemporaneous cost” refers to both contemporaneous cost and contemporaneous proceeds (or either of them). Single terms in parentheses within sentences, such as the term “(proceeds),” refer specifically to customer sale transactions where the member charges a mark-down.
  - 2 Under Rule 144A of the Securities Act of 1933 (Securities Act), the definition of QIB includes, among others: (1) specified entities (including insurance companies, registered investment companies, employee benefit plans or similar plans maintained by a state, or a state agency or political subdivision, and investment advisors) that act for their own account or the accounts of other QIBs, that in the aggregate own and invest on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the entity; (2) any broker-dealer registered pursuant to Section 15 of the Securities Exchange Act of 1934 (Act), acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least \$10 million of securities of issuers that are not affiliated with the broker-dealer; (3) any broker-dealer acting in a riskless principal transaction on behalf of a QIB; (4) any investment company registered under the Investment Company Act of 1940, acting for its own account or for the accounts of other QIBs, that is part of a family of investment companies that own in the aggregate at least \$100 million in securities of issuers, other than issuers that are affiliated with the investment company or are part of such family of investment companies; and (5) any bank or certain other domestic and foreign financial institutions, acting for its own account or the accounts of other QIBs, that in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with it and that has an audited net worth of at least \$25 million.
  - 3 A broker-dealer may also be liable for excessive mark-ups under the anti-fraud provisions of the Securities Act and the Act. See Section 10(b)(5) of the Act and Rule 10b-5 thereunder, and Section 17(a) of the Securities Act.
  - 4 See IM-2440-2, paragraph (a)(1).
  - 5 See Section 3(a)(29) of the Act. “Municipal securities” include, among others, tax-exempt general obligation bonds and tax-exempt industrial revenue bonds. Transactions in municipal securities involving unfair pricing, including unfair mark-ups, are subject to the rules of the Municipal Securities Rulemaking Board (MSRB) and the anti-fraud provisions of the Securities Act and the Act. See note 3.
  - 6 See Section 3(a)(12) of the Act. “Exempted securities” include, among others: government securities, as defined in Section 3(a)(42) of the Act; municipal securities, as defined in Section 3(a)(29) of the Act; any interest in any common trust fund or similar fund that is excluded from the definition of the term “investment company” under the Investment Company Act of 1940; any interest in any common trust fund, or a collective trust fund maintained by a bank, or any security arising out of a contract issued by an insurance company, which interest, participation or security is issued in connection with a qualified plan; any security issued by or any interest or participation in any pooled income fund, collective trust fund, collective investment fund, or similar fund that is excluded from the definition of an investment company; certain securities issued by or any interest in any church plan, company, or account that is excluded from the definition of an investment company; and other securities that the Commission may, by rules, exempt from any one or more provisions of the federal securities laws
- NASD Rule 2110 (J&E rule) applies to broker-dealers charging excessive mark-ups or commissions in exempted securities transactions (other than municipal securities transactions). See Securities Exchange Act Release No. 37588 (August 20, 1996), 61 FR 44100 (August 27, 1996) (SR-NASD-1995-39) (order approving

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the application of the NASD's Rules of Fair Practice to transactions in exempted securities (except municipal securities)). In the order, the Commission states that for transactions in government securities between broker-dealers and customers, NASD may address conduct that is "similar to conduct that may violate the 'Fair Prices and Commissions' provision and the 'Mark-Up Policy'" under Rule 2110. The Commission said an NASD statement in the rule filing regarding this application of the J&E rule "merely clarifies and reminds members that its rules requiring members to adhere to just and equitable principles of trade apply to conduct that may violate the Fair Prices and Commissions provision and the Mark-Up Policy..." and the "rule requiring that members adhere to just and equitable principles of trade would have applied to such conduct regardless of this clarification." 61 FR 44100, 44113. Also, such conduct is subject to the anti-fraud provisions of the Securities Act and the Act. See note 3. See also NASD Rule 0116, paragraph (b).

- 7 See IM-2440-2, paragraphs (b)(1), (2) and (4).
- 8 See IM-2440-2, paragraph (b)(4).
- 9 See IM-2440-2, paragraphs (b)(5)(A) through (C).
- 10 See IM-2440-2, paragraph (b)(6).
- 11 See IM-2440-2, paragraphs (c)(1) and (2).
- 12 See IM-2440-2, paragraphs (c)(2)(A) through (D).
- 13 See IM-2440-2, paragraph (c)(3).
- 14 See IM-2440-2, paragraph (c)(1).
- 15 See IM-2440-2, paragraphs (b)(6) and (b)(8).
- 16 See IM-2440-2, paragraph (b)(7).
- 17 *Id.*
- 18 See IM-2440-2, paragraph (b)(9).
- 19 *Id.*

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## ATTACHMENT A

New language is underlined; deletions are in brackets.

### IM-2440-1. Mark-Up Policy

The question of fair mark-ups or spreads is one which has been raised from the earliest days of the Association. No definitive answer can be given and no interpretation can be all-inclusive for the obvious reason that what might be considered fair in one transaction could be unfair in another transaction because of different circumstances. In 1943, the Association's Board adopted what has become known as the "5% Policy" to be applied to transactions executed for customers. It was based upon studies demonstrating that the large majority of customer transactions were effected at a mark-up of 5% or less. The Policy has been reviewed by the Board of Governors on numerous occasions and each time the Board has reaffirmed the philosophy expressed in 1943. Pursuant thereto, and in accordance with Article VII, Section 1(a)(ii) of the By-Laws, the Board has adopted the following interpretation under Rule 2440.

It shall be deemed a violation of Rule 2110 and Rule 2440 for a member to enter into any transaction with a customer in any security at any price not reasonably related to the current market price of the security or to charge a commission which is not reasonable.

(a) through (d) No change.

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## IM-2440-2. Additional Mark-Up Policy For Transactions in Debt Securities, Except Municipal Securities<sup>1</sup>

### (a) Scope

(1) IM-2440-1 applies to debt securities transactions, and this IM-2440-2 supplements the guidance provided in IM-2440-1.

### (b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this IM-2440-2, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with NASD pricing rules. (See, e.g., Rule 2320).

(2) When the dealer is selling the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases in the security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price. When the dealer is buying the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous sales in the security or can show that in the particular circumstances the dealer's contemporaneous proceeds are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or, the dealer's proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing; (ii) the credit quality of the debt security changed

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significantly after the dealer's contemporaneous transaction; or (iii) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the dealer's contemporaneous transaction.

(5) In instances where the dealer has established that the dealer's cost is (or, in a mark-down, proceeds are) no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described in (b)(4)(i), (ii) and (iii), a member must consider, in the order listed, the following types of pricing information to determine prevailing market price:

(A) Prices of any contemporaneous inter-dealer transactions in the security in question;

(B) In the absence of transactions described in (A), prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security; or

(C) In the absence of transactions described in (A) and (B), for actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

(A member may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information (e.g., a member may consider pricing information under (B) only after the member has determined, after applying (A), that there are no contemporaneous inter-dealer transactions in the same security.) In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (i.e., either a particular transaction price, or, in (C) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (i.e., such as whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction and timeliness of the information).

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

- Prices of contemporaneous inter-dealer transactions in a "similar" security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a "similar" security with institutional accounts with which any dealer regularly effects transactions in the "similar" security with respect to customer mark-ups (mark-downs);

- 
- Yields calculated from prices of contemporaneous inter-dealer transactions in “similar” securities;
  - Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in “similar” securities with respect to customer mark-ups (mark-downs); and
  - Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in “similar” securities for customer mark-ups (mark-downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (i.e., whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

(7) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, NASD or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (e.g., discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (e.g., coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(8) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of “similar” securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in “similar” securities taken as a whole.

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(9) "Customer," for purposes of Rule 2440, IM-2440-1 and this IM-2440-2, shall not include a qualified institutional buyer ("QIB") as defined in Rule 144A under the Securities Act of 1933 that is purchasing or selling a non-investment grade debt security when the dealer has determined, after considering the factors set forth in IM-2310-3, that the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction. For purposes of Rule 2440, IM-2440-1 and this IM-2440-2, "non-investment grade debt security" means a debt security that: (i) if rated by only one nationally recognized statistical rating organization ("NRSRO"), is rated lower than one of the four highest generic rating categories; (ii) if rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by any of the NRSROs; or (iii) if unrated, either was analyzed as a non-investment grade debt security by the dealer and the dealer retains credit evaluation documentation and demonstrates to NASD (using credit evaluation or other demonstrable criteria) that the credit quality of the security is, in fact, equivalent to a non-investment grade debt security, or was initially offered and sold and continues to be offered and sold pursuant to an exemption from registration under the Securities Act of 1933.

**(c) "Similar" Securities**

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar," as that term is used in this IM-2440-2, to the subject security may be determined by factors that include but are not limited to the following:

(A) Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as "similar" securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (e.g., changes to ratings outlooks));

(B) The extent to which the spread (i.e., the spread over U.S. Treasury securities of a similar duration) at which the "similar" security trades is comparable to the spread at which the subject security trades;

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(C) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and

(D) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

1. The Interpretation does not apply to transactions in municipal securities. Single terms in parentheses within sentences, such as the terms "(sale)" and "(to)" in the phrase, "contemporaneous dealer purchase (sale) transactions with institutional accounts," refer to scenarios where a member is charging a customer a mark-down.

# Notice to Members

JUNE 2007

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Senior Management

## KEY TOPICS

Clearing Firms  
Introducing Firms  
NASD Rule 2342  
Securities Investor Protection Act of 1970 (SIPA)  
Securities Investor Protection Corporation (SIPC)  
SIPC Brochure  
SIPC Web Site

## GUIDANCE

### SIPC Information

SEC Approves Rule 2342 Setting Forth Requirements for Providing SIPC Information to Customers;  
**Effective Date: November 6, 2007**

#### Executive Summary

On May 10, 2007, the Securities and Exchange Commission (SEC) approved NASD Rule 2342 setting forth requirements for providing Securities Investor Protection Corporation (SIPC) information to customers.<sup>1</sup> Under Rule 2342, all members—unless they are excluded from membership in SIPC and are not SIPC members, or they exclusively sell investments that are ineligible for SIPC protection—are required to advise all new customers that they may obtain information about SIPC, including the SIPC brochure, by contacting SIPC. Such members also must provide SIPC's Web site address and telephone number. Members must provide this disclosure to new customers, in writing, at the opening of an account and also must provide customers with the same information, in writing, at least once each year. The effective date is **November 6, 2007**.

Included with this *Notice* is Attachment A, the text of Rule 2342.

#### Questions/Further Information

Questions concerning this *Notice* may be directed to Susan M. DeMando, Associate Vice President, Financial Operations, Department of Member Regulation, at (202) 728-8411; or Patricia Albrecht, Assistant General Counsel, Office of General Counsel, at (202) 728-8026.

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## Background and Discussion

On May 25, 2001, the Government Accountability Office (GAO) issued *Securities Investor Protection: Steps Needed to Better Disclose SIPC Policies to Investors* (GAO-01-653). In that report, the GAO made recommendations to the SEC and SIPC about ways to improve the information available to the public about SIPC and the Securities Investor Protection Act of 1970 (SIPA). Among other things, the GAO recommended that self-regulatory organizations (SROs) explore ways to encourage broader dissemination of the SIPC brochure to customers so that they can become more aware of the scope of coverage of SIPA.<sup>2</sup> The GAO also recommended that the SROs consider requiring firms to include information on periodic statements or trade confirmations advising investors that they should document account discrepancies in writing. In July 2003, the GAO issued an updated report (*Securities Investor Protection: Update on Matters Related to the Securities Investor Protection Corporation*), in which it noted that the SEC was working with SROs to explore ways in which the GAO's recommendations could be implemented.

As described below, NASD has made two rule changes in response to the GAO's recommendations.<sup>3</sup>

### **New Rule 2342**

This *Notice* announces the SEC's recent approval of new Rule 2342, which requires all members, except those members that (1) pursuant to Section 3(a)(2)(A)(i) through (iii) of SIPA are excluded from membership in SIPC<sup>4</sup> and that are not SIPC members, or (2) those members whose business consists exclusively of the sale of investments that are ineligible for SIPC protection, to advise all new customers, in writing, at the opening of an account, that they may obtain information about SIPC, including the SIPC brochure, by contacting SIPC. Such members also must provide SIPC's Web site address ([www.sipc.org](http://www.sipc.org)) and telephone number ((202) 371-8300). In addition, such members must provide customers with the same information, in writing, at least once each year. In cases where both an introducing firm and clearing firm service an account, the firms may assign these requirements to one of the firms. Rule 2342 becomes effective on **November 6, 2007**.

### **Amendment to Rule 2340**

NASD previously announced the SEC's approval of an amendment to Rule 2340 (Customer Account Statements) in *Notice to Members 06-72* (December 2006). The amendment to Rule 2340 requires account statements to include a statement advising each customer to report promptly any inaccuracy or discrepancy in that person's account to his or her brokerage firm and clearing firm (where these are different firms). This statement also must advise the customer that any oral communication should be re-confirmed in writing to further protect the customer's rights, including rights under SIPA. The amendment to Rule 2340 went into effect on **May 31, 2007**.<sup>5</sup>

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## Endnotes

- 1 Securities Exchange Act Release No. 55737 (May 10, 2007), 72 FR 27606 (May 16, 2007) (SR-NASD-2006-124), as corrected by SR-NASD-2007-036 (June 1, 2007).
- 2 In brief, the SIPC brochure describes such things as the role of SIPC, what SIPC covers and what it does not, and how SIPC operates if a brokerage firm fails.
- 3 The New York Stock Exchange has made similar amendments to NYSE Rule 409 (Statements of Accounts to Customers) in response to the GAO's recommendations. See Securities Exchange Act Release No. 54904 (December 8, 2006), 71 FR 75600 (December 15, 2006) (SR-NYSE-2005-09) (effective May 31, 2007).
- 4 Under Section 3(a)(2)(A)(i) through (iii) of SIPA, members of SIPC include all persons registered as brokers or dealers under section 15(b) of the Exchange Act, other than:
  - (1) persons whose principal business, in the determination of SIPC, taking into account business of affiliated entities, is conducted outside the United States and its territories and possessions;
  - (2) persons whose business as a broker or dealer consists exclusively of (a) the distribution of shares of registered open end investment companies or unit investment trusts, (b) the sale of variable annuities, (c) the business of insurance, or (d) the business of rendering investment advisory services to one or more registered investment companies or insurance company separate accounts; and
  - (3) persons who are registered as a broker or dealer pursuant to section 15(b)(11)(A) of the Exchange Act [pertaining to registration with respect to transactions in security futures products].
- 5 See Securities Exchange Act Release No. 54411 (September 7, 2006), 71 FR 54105 (September 13, 2006) (SR-NASD-2004-171), as corrected by Securities Exchange Act Release No. 54411A (October 6, 2006), 71 FR 61115 (October 17, 2006) (SR-NASD-2004-171). See also Securities Exchange Act Release No. 54872 (December 5, 2006) (Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to Establishing an Effective Date for Amendments to NASD Rule 2340); File No. SR-NASD-2006-128.

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## ATTACHMENT A

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### 2000. BUSINESS CONDUCT

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#### 2300. Transactions with Customers

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##### 2342. SIPC Information

All members, except those members: (a) that pursuant to Section 3(a)(2)(A)(i) through (iii) of the Securities Investor Protection Act of 1970 (SIPA) are excluded from membership in the Securities Investor Protection Corporation (SIPC) and that are not SIPC members; or (b) whose business consists exclusively of the sale of investments that are ineligible for SIPC protection, shall advise all new customers, in writing, at the opening of an account, that they may obtain information about SIPC, including the SIPC brochure, by contacting SIPC, and also shall provide the Web site address and telephone number of SIPC. In addition, such members shall provide all customers with the same information, in writing, at least once each year. In cases where both an introducing firm and clearing firm service an account, the firms may assign these requirements to one of the firms.

# Notice to Members

**JUNE 2007**

## SUGGESTED ROUTING

Legal & Compliance  
Operations  
Registered Representatives  
Senior Management  
Training

## KEY TOPICS

Correspondence – General  
Electronic Communications  
Rule 2210 (Communications with the Public)  
Rule 2211 (Institutional Sales Material and Correspondence)  
Rule 3010 (Supervision)  
Supervision

## JOINT REQUEST FOR COMMENT

### Supervision of Electronic Communications

NASD and NYSE Request Comment on Proposed Joint Guidance Regarding the Review and Supervision of Electronic Communications; **Comment Period Expires July 13, 2007**

#### Executive Summary

Given the pace of technological innovations in electronic communications, and the breadth of possible communications subject to review, NASD and NYSE are issuing this Joint Request for Comment to solicit comments from members and other interested parties on proposed Joint Guidance regarding the review and supervision of electronic communications. The proposed Joint Guidance sets forth principles for members to consider when developing supervisory systems and procedures for electronic communications that are reasonably designed to achieve compliance with applicable federal securities laws and self-regulatory organization rules.

Attachment A sets forth the proposed Joint Guidance on the review and supervision of electronic communications.

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## Action Requested

Comment on the proposed Joint Guidance. Comments must be received by July 13, 2007. Members and other interested persons can submit their comments using the following methods:

- ◆ E-mailing 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 (or submitted pursuant to NYSE's stated methods). All comments received by NASD in response to this Joint Request for Comment will be made available to the public on the NASD Web site. Generally, comments will be posted on the NASD Web site one week following the expiration of the comment period.<sup>1</sup>

## Questions/Further Information

Questions concerning this Joint Request for Comment should be directed to Donald K. Lopez, Deputy Director, Examinations Program, at (202) 728-8132; or Patricia Albrecht, Assistant General Counsel, Office of General Counsel, at (202) 728-8026.

## Endnote

- <sup>1</sup> See *NASD 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.

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## **ATTACHMENT A – PROPOSED JOINT GUIDANCE**

### **REVIEW AND SUPERVISION OF ELECTRONIC COMMUNICATIONS**

#### **I. INTRODUCTION**

Technological innovations in the area of electronic communications<sup>1</sup> have altered how people deliver, receive, and store communications. These innovations have brought, and continue to bring, new challenges to members<sup>2</sup> in the establishment of supervisory systems and procedures for electronic communications that are reasonably designed to achieve compliance with applicable federal securities laws and self-regulatory organization rules.<sup>3</sup>

With these challenges in mind, the NYSE and NASD (the “SROs”) are issuing this guidance for members to consider when developing such systems and procedures. In the course of formulating this guidance, the SROs have consulted with industry experts in addition to drawing on their own experience in the area of electronic communication supervision. This guidance does not specifically address every regulatory issue that may arise in connection with the supervision of electronic communications. Further, the SROs recognize that policies and procedures may differ among members depending on their business model (e.g., size, structure, customer base, and product mix).<sup>4</sup>

#### **II. REVIEW AND SUPERVISION OF ELECTRONIC COMMUNICATIONS**

At one time, the SROs required that members review all correspondence of their registered representatives pertaining to the solicitation or execution of any securities transactions. In 1998, recognizing that the growing use of electronic communications such as e-mail made adherence to this requirement difficult, the SROs amended their rules to allow members the flexibility to design supervisory review procedures for correspondence with the public that are appropriate to the individual member’s business model.<sup>5</sup>

In considering this Joint Guidance, members generally may decide by employing risk-based principles the extent to which the review of electronic communications, both internal and external, is necessary in accordance with the supervision of their business. However, members must have policies and procedures for the review by a supervisor of employees<sup>6</sup> incoming and outgoing electronic communications that are of a subject matter that require review under SRO rules and federal securities laws. For example (without limitation):

- (1) NYSE Rule 472(b)(3) and NASD Rule 2711(b)(3)(A) require that a member’s legal and compliance department be copied on communications between non-research and research departments concerning the content of a research report; NYSE Rule 472(a) and NASD Rules 2210 and 2211 require pre-approval by a principal of specified communications with the public;
- (2) NYSE Rule 351(d) and NASD Rule 3070(c) require the identification and reporting of customer complaints; NYSE Rule 401A requires that the receipt of each complaint be acknowledged by the member to the customer within 15 business days; and
- (3) NYSE Rule 410 and NASD Rule 3110(j) require the identification and prior written approval of every order error and other account designation change.

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When employing risk-based procedures to review electronic communications, members should consider how to effectively:

- (1) “flag” electronic communications that may evidence or contain customer complaints, problems, errors, orders, or other instructions for an account; or evidence conduct inconsistent with SRO rules, federal securities laws, and other matters of importance to the member’s ability to adequately supervise its business and manage the member’s reputational, financial, and litigation risk;
- (2) identify such other business areas the member may identify as warranting supervisory review; and
- (3) educate employees to understand and comply with the member’s policies and procedures regarding electronic communications.

In adopting such supervisory review procedures, existing interpretive material directs members to, among other things:<sup>7</sup>

- Identify the types of correspondence that will be pre- or post-reviewed;
- Identify the organizational position(s) responsible for conducting reviews of the different types of correspondence;
- Monitor the implementation of, and compliance with, the member’s procedures for reviewing public correspondence;<sup>8</sup>
- Periodically re-evaluate the effectiveness of the member’s procedures for reviewing public correspondence and consider any necessary revisions;<sup>9</sup>
- Provide that all customer complaints, whether received via e-mail or in other written form, are reported to the SROs in compliance with the SRO reporting requirements;<sup>10</sup>
- Prohibit employees from the use of electronic communications unless such communications are subject to supervisory and review procedures developed by the member;<sup>11</sup> and
- Conduct necessary and appropriate training and education.

Member electronic communications related to a member’s business are subject to its overall supervisory and review procedures.<sup>12</sup> They are also subject to SRO rule requirements specifically addressing communications with the public.<sup>13</sup>

The growth of electronic communications has raised the need for further interpretative guidance. For ease of use, the guidance that follows is divided into six categories:

- Written Policies and Procedures
- Types of Electronic Communications Requiring Review
- Identification of the Person(s) Responsible for the Review of Electronic Communications
- Method of Review for Correspondence
- Frequency of the Review of Correspondence
- Documentation of the Review of Correspondence

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## A. WRITTEN POLICIES AND PROCEDURES

The path towards an effective supervisory system starts with clear policies and procedures for the general use and supervision of electronic communications, both internal and external, which are updated to address new technologies. For example, a general electronic communications policy written five years ago may well not include policies to regulate employees' use of technologies such as weblogs<sup>14</sup> and podcasting<sup>15</sup> to communicate with the public.

From a general procedural perspective, members should provide their employees with the following:

- Quick and easy access to electronic communication policies and procedures through, for example, the member's intranet system. (Members should make clear to all employees that they are responsible for complying with these policies and procedures upon their employment. Updates to such policies should be made accessible to all employees in a timely manner, pursuant to the member's procedures.)
- A clear list of permissible electronic communication mechanisms (including a clear statement that all other mechanisms are prohibited). For example, if employees are permitted to utilize only the member's e-mail and instant messaging system, then this should be clearly and unambiguously stated in the member's policies and procedures. Members should also make clear if certain communication mechanisms may only be used for communications between employees of the member (versus mechanisms that may also be used for communications with the public). Members should be cognizant that vague language addressing these issues may leave room for unwanted individual interpretation.
- Specific language explaining to employees the potential consequences of non-compliance (e.g., disciplinary action).
- Training on a regular and as-needed basis. Members should include information in their training and compliance programs describing examples of permissible and prohibited technologies. In addition, while all employees should receive training with respect to the member's general electronic communication policies and procedures, there may be certain employees whose training should be further tailored to their specific business function. For example, a member may implement additional prohibitions on internal communications between business units that are privy to certain non-public information (e.g., investment banking and research and proprietary trading).

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## B. TYPES OF ELECTRONIC COMMUNICATIONS REQUIRING REVIEW

### External Communications

As discussed above, members must have reasonable policies and procedures for the supervisory review of electronic communications that require review under SRO rules<sup>16</sup> and federal securities laws. Members may employ risk-based principles to determine the extent to which additional supervisory policies and procedures are required to adequately supervise their business and manage the member's reputational, financial, and litigation risk.

Members also are required to establish policies and procedures regarding the forms of electronic communications that they permit employees to use when conducting business with the public and to take reasonable steps to monitor for compliance with such policies and procedures.

Traditionally, members have limited employees' electronic communications with customers to a member-supplied e-mail address that is connected to the member's communication network. However, as technology has evolved, employees now have a myriad of ways to communicate electronically with the public. To the extent members prohibit certain types of communication media, consideration should be given to taking technological steps to block or otherwise regulate their external and internal use. In particular, members should consider the following options:

**Non-Member E-Mail Platforms** – Employees have the ability to communicate via e-mail through means other than their member-issued e-mail address by accessing e-mail platforms through the Internet (e.g., through AOL or Yahoo mail) and through third-party communication systems such as Bloomberg and Reuters. If a member permits employees to communicate with customers through these systems or through other non-member e-mail addresses, the member is required to supervise and retain those communications. Some members prohibit, through policies and procedures, employees from accessing non-member e-mail platforms for business purposes, and require employees to certify on an annual or more frequent basis that they are acting consistent with such policies and procedures. Where possible, some members have chosen to block access to these e-mail platforms through their networks. Thus, an employee would be able to access the Internet but not the e-mail functionality. Members utilizing this blocking functionality should periodically conduct tests to ensure that it is functioning as designed or intended.

Similarly, the SROs expect members to prohibit, through policies and procedures, communications with the public for business purposes from employees' own electronic devices unless the member is capable of supervising, receiving, and retaining such communications.<sup>17</sup> Absent a prohibition, members should consider requiring pre-approval for the business-related use of any personal electronic communications device. The approval process might require a detailed business justification for using the personal device and an annual re-certification of the approval that includes a re-evaluation of the business justification for its use. In addition, members should consider obtaining agreements from employees authorizing the member to access any such personal electronic communications devices. Members should also consider prohibiting, where appropriate, the use of personal electronic communication devices in certain sensitive firm locations (e.g., where material non-public information could be accessed).

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**Message Boards** – There are various publicly accessible message boards related to the securities industry. Members may consider blocking access by their employees to these message boards<sup>18</sup> to prevent them from communicating through these boards for business purposes.

**E-Faxes** – The use of traditional facsimile machines has started to decline as E-fax software has developed. The SROs view E-faxes as electronic communications and, thus, members should supervise them accordingly.<sup>19</sup>

When a member permits the use of any technology, the member's system of supervision should be reasonably designed to achieve compliance with applicable laws, rules, and regulations.

### **Internal Communications**

As stated above, with the exception of the enumerated areas requiring review by a supervisor, members may decide, employing risk-based principles, the extent to which review of any internal communications is necessary in accordance with the supervision of their business.

Subject to any such specific rule requirement mandating reviews, in reaching a risk-based assessment regarding the review of internal communications, consideration should be given to, for instance: detecting when a member's information barriers are not working to protect customer or issuer information; protecting against undue influence on research personnel contrary to SRO rules; and segregating the member's proprietary trading desk activity from all or part of the other operating areas of the member.<sup>20</sup>

In addition, members may consider various relevant existing processes, such as:

- Conflict-management efforts - Steps taken to reduce, manage, or eliminate potential conflicts of interest, including implementing firewalls to prevent electronic communications between certain individuals/groups or monitoring communications as required by SRO rules (e.g., between non-research and research departments) or as otherwise appropriate. Members should review to determine whether adequate information barriers are in place.
- Reviews of internal electronic communications that occur in connection with branch or desk examinations and regulatory inquiries, examinations, or investigations.
- Reviews of internal electronic communications that occur in connection with transaction reviews, internal disciplinary reviews, and reviews relating to customer complaints or arbitration.
- Reviews of internal electronic communications that occur as a result of issues identified in connection with external electronic communication reviews.

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**C. IDENTIFICATION OF THE PERSON(S) RESPONSIBLE FOR THE REVIEW OF ELECTRONIC COMMUNICATIONS**

Members' procedures for review of electronic communications (internal and external) should address the following:

- Members' procedures should clearly identify the person(s) responsible for performing the reviews. Evidence of review can be satisfied by use of a log or other record from the electronic communication system that identifies the reviewers.
- The supervisor/principal must evidence his or her supervision as required by SRO rules.<sup>21</sup>
- In the course of supervising electronic communications, a supervisor/principal may delegate certain functions to persons who need not be registered.<sup>22</sup> However, the supervisor/principal remains ultimately responsible for the performance of all necessary supervisory reviews, irrespective of whether he or she delegates functions related to the review. Accordingly, supervisors must take reasonable and appropriate action to ensure delegated functions are properly executed and should evidence performance of their procedures sufficiently to demonstrate overall supervisory control.<sup>23</sup>
- Where review functions are delegated, the procedures must provide a protocol to escalate regulatory issues to the designated supervisor or other appropriate department.
- All reviewers must have sufficient knowledge, experience, and training to adequately perform the reviews. Members should be able to demonstrate that the reviewers meet these criteria. This could include: prior supervisory or other experience, years of service in the industry, professional licenses, completion of firm and regulatory element training, product knowledge, educational degrees, knowledge of member products and services, lecturing at, or attending, industry seminars and courses, other training, length of service at the member, familiarity with member systems and tools, and prior regulatory experience.
- Unless a member's size and/or structure (e.g., a sole proprietor) is such that the member has no other reasonable alternative for reviewing an individual's electronic communications, an individual may not conduct supervisory reviews of his or her own electronic communications.

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#### D. METHOD OF REVIEW FOR CORRESPONDENCE

Members should develop review procedures that are both reasonably designed to achieve compliance with applicable securities laws, regulations, and SRO rules and appropriate for their business and structure, consistent with the principles set forth in this Joint Guidance. In addition, members should monitor for compliance with their supervisory procedures' prescribed frequency, timeliness, and quantity parameters.

Regardless of the method utilized, members should alert their reviewers as to the issues to be raised and material to be examined, including acceptable content. For example, members should make reference to the content standards in NYSE Rule 472 and NASD Rule 2210 and provide guidance concerning other applicable areas of concern (e.g., the use of confidential, proprietary, and inside information; anti-money laundering issues; gifts and gratuities; private securities transactions; customer complaints; front-running; and rumor spreading). When reviewing customer complaints, members should look for indicia that a customer has received a communication that is not in conformance with the member's policies and procedures.

In addition, where members permit the use and receipt of encrypted electronic communications, they must be able to monitor and supervise those communications and must educate reviewers on how this can be accomplished. (See "Combination of Lexicon and Random Review of Electronic Correspondence" below).

Furthermore, members must be able to review electronic correspondence in all languages in which they conduct business with the public. Therefore, if the reviewer is not fluent in the language used in an e-mail, the member should require proper independent interpretation and review (*i.e.*, not by the author/recipient of the correspondence).

Under limited circumstances, members should consider having their legal and/or compliance departments re-review e-mails that have already been reviewed by line supervisors and their delegates in certain situations. Re-review might be advisable when specific problems have been identified at a branch office resulting, for instance, in a registered representative becoming the subject of an internal investigation. Members should also consider re-reviewing selected electronic communications as part of their standard branch office inspection program.

Against this background, members may consider the following methods of review:

- **Lexicon-based Reviews of Electronic Correspondence** – Members using lexicon-based reviews (those based on sensitive words or phrases, the presence of which may signal problematic communications) of correspondence should utilize an appropriate lexicon, take reasonable security measures to keep the list confidential, and periodically evaluate the efficacy of the lexicon. Members must make informed decisions regarding how best to utilize the surveillance tools they have chosen. Thus, a member that conducts lexicon-based reviews may determine that it is not necessary to review each and every lexicon "hit" in order to maintain an effective review system. The rationale for such determinations should be maintained as part of the member's policies and procedures.

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Members should also consider regular periodic reviews of the lexicon system to determine whether any changes/updates are necessary, such as adding or deleting phrases and/or words. Members should periodically inquire as to the effectiveness of the system, especially if the system is that of a vendor.<sup>24</sup> Members are responsible for ensuring that the system utilized is functioning properly. As discussed more fully below, if a member does not have confidence in the effectiveness of its lexicon system, a supplemental random review of electronic communications should be considered.

Members should consider targeted concentrated reviews of employees' e-mails when warranted (e.g., when concerns are raised in connection with regulatory examination findings, internal audits, customer complaints, or regulatory inquiries).

When assessing the effectiveness of a lexicon-based system, members should consider the following features:

- (a) A meaningful list of phrases and/or words (including industry "jargon") based on the size of the member, its type of business, its customer base, and its location (including any branch offices that may require the inclusion of certain foreign language components). The lexicon system should be comprehensive enough to yield a meaningful sample of "flagged" communications.
  - (b) Ability to add and delete phrases and words on an ongoing basis.
  - (c) Ability to review attachments and identify attachments that could circumvent lexicon-based reviews.
  - (d) Ability to restrict access to the phrases and/or words that make up the lexicon system.
  - (e) Ability to conduct searches that exclude any trailers or disclaimers used by the member, as these trailers or disclaimers often contain sensitive words such as "guarantee" (e.g., "firm does not guarantee") which would "flag" every such e-mail.
- **Random Review of Electronic Correspondence** – Members may choose to use a reasonable percentage sampling technique, whereby some percentage of the electronic communications generated by the member is reviewed. There is no prescribed minimum or fixed percentage that is required by regulation. However, the amount of electronic communications chosen for review must be reasonable given the circumstances (for example, member size, nature of business, customer base, and individual employee circumstances). In this regard, members conducting random reviews may consider factors such as:
    - (a) **Percentage of Electronic Correspondence Based on a Branch Office, Department, or Business Unit** - For a branch office, department, or business unit, a member could establish a percentage of electronic communications requiring review that is based on its size, type of business, customer base, and location (including its sales locations), which includes e-mails from each individual in that branch office, department, or business unit.
    - (b) **Percentage of Electronic Correspondence for Each Individual** - For each individual in a branch office, department, or business unit, a member could establish a percentage of e-mails requiring review based on its size, type of business, supervisory structure (including whether certain locations are supervised remotely), customer base, and location including its branch offices. Members should not necessarily limit themselves to reviewing the same percentage of e-mails for each employee. For example, an individual with disciplinary history or subject to special supervision may warrant a review encompassing a higher percentage of e-mails.

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- **Combination of Lexicon and Random Review of Electronic Correspondence** – Given the strengths and weaknesses of any single review tool, members should consider complementary review techniques. For instance, members should note that while lexicon system-tracking capabilities have become considerably more sophisticated and effective over the past few years, as of this writing they are incapable of reading documents or document attachments that are password protected or encrypted. Further, the use of image files, such as “jpgs,” can be used to pass information through lexicon filters undetected. In addition, a registered representative determined to circumvent a lexicon system may be able to do so by simply avoiding the use of words likely to “trigger” the system.
  - **Standards Applicable to All Review Systems** – The manner and extent to which review tools are utilized is a determination to be made by each member, based on its business model. However, to best assure the effectiveness over time of any system, members should incorporate ongoing evaluation procedures to identify and address any “loopholes” or other issues that may arise as the means of transmitting sensitive information “under the regulatory radar” become more sophisticated and difficult to capture. Members’ written procedures should delineate the additional reviews that will be conducted when such issues are identified. Members utilizing automated tools or systems in the course of their supervisory review of electronic communications must have an understanding of the limitations of such tools or systems (for example, see the potential limitations of lexicon systems noted above) and should consider what, if any, further supervisory review is necessary in light of such limitations.<sup>25</sup>

#### **E. FREQUENCY OF THE REVIEW OF CORRESPONDENCE**

- Frequency of correspondence review may vary depending on the business. For instance, the frequency of review should be related to the type of business conducted (*i.e.*, the market sensitivity of the activity); the type of customers involved; the scope of the activities; the geographical location of the activities; the disciplinary record of covered persons; and the volume of the communications subject to review.
- Members should prescribe reasonable timeframes within which supervisors are expected to complete their reviews of correspondence, taking into consideration the type of review being conducted and the method of review being used. When determining the reasonableness of such timeframes, members should carefully consider the type of business their firm is conducting and the extent to which a review’s usefulness, in the context of that business, is diminished by the passage of time. For example, a member with a primarily retail customer base may need to conduct more frequent reviews than a member that exclusively conducts institutional business.

#### **F. DOCUMENTATION OF THE REVIEW OF CORRESPONDENCE**

- Members must evidence their reviews, whether electronically or on paper,<sup>26</sup> and be able to reasonably demonstrate that such reviews were conducted.
- The evidence of review should, at a minimum, clearly identify the reviewer, the communication that was reviewed, the date of review, and the steps taken as a result of any significant regulatory issues that were identified during the course of the review. Members should remind their reviewers that merely opening the communication will not be deemed a sufficient review.

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### III. CONCLUSION

As noted above, the SROs are issuing this Joint Guidance to assist members in the establishment and maintenance of supervisory systems for electronic communications that are reasonably designed to achieve compliance with the federal securities laws and self-regulatory organization rules. Members must recognize, however, that this guidance is not all-inclusive and does not represent all areas of inquiry that a member should consider when establishing and maintaining a supervisory system for electronic communications, including any existing and future electronic communications technology that this guidance may not address. In addition, members are advised that this guidance does not serve to establish a safe harbor with respect to potential supervisory or compliance deficiencies.

#### Endnotes

- 1 For purposes of this Joint Guidance, "electronic communications," "e-mail," and "electronic correspondence" may be used interchangeably and can include such forms of electronic communications as instant messaging and text messaging. Notwithstanding such use of terminology, as further detailed herein, the manner of application of SRO rules specifically addressing particular communications with the public (see, e.g., NASD Rules 2210 and 2211 and NYSE Rules 342 and 472) will depend on the type of communication.
- 2 For purposes of this Joint Guidance, the term "member" refers to NYSE member organizations and NASD members.
- 3 See NYSE Rule 342 (Offices – Approval, Supervision and Control) and NASD Rule 3010 (Supervision).
- 4 The SROs have fashioned rule provisions that, where appropriate, take into account variations in members' size or business model. See, e.g., NYSE Rules 342.23 (Offices – Approval, Supervision and Control – Internal Controls) and 472(m) (Communications with the Public – Small Firm Exception). See also NASD Rules 3012 (Supervisory Control System) and 2711 (Research Analysts and Research Reports).
- 5 See NYSE Information Memo 98-3 (January 16, 1998) and *NASD Notices to Members 98-11* (January 1998) and *99-03* (January 1999). See also NYSE Rule 342.17 (Offices – Approval, Supervision and Control – Review of Communications with Public) and NASD Rule 3010 (Supervision). Additionally, NASD Rule 2211 (Institutional Sales Material and Correspondence) defines "correspondence" as any written letter or electronic mail message distributed by a member to (1) one or more existing retail customers, and (2) fewer than 25 prospective retail customers within any 30 calendar-day period.
- 6 Members are not required to approve outgoing "correspondence" prior to use unless the correspondence is sent to 25 or more existing retail customers within a 30 calendar-day period and makes a financial or investment recommendation or otherwise promotes a product or service of the member. NASD Rule 2211 also allows members to adopt supervisory procedures for communications distributed only to certain institutional investors that do not require principal pre-use review and approval. See also SR-NYSE-2007-49 which proposes amendments that would generally exempt from pre-use review and approval correspondence and institutional sales material, as defined.
- 7 For purposes of NASD rules, the term "employees" includes all associated persons.
- 8 See NYSE Information Memo 98-3 (January 16, 1998) and *NASD Notice to Members 98-11* (January 1998).
- 9 The SROs recognize that, as appropriate evidence of review, e-mail related to members' investment banking or securities business may be reviewed electronically and the evidence of the review may be recorded electronically (see NYSE Information Memo 98-3 and *NASD Notice to Members 98-11*).
- 10 See also NYSE Rule 342 and NASD Rule 3012, requiring implementation of a supervisory control system.
- 11 See NYSE Rule 351(d) (Reporting Requirements) and NASD Rule 3070(c) (Reporting Requirements).
- 12 For example, the SROs expect members to prohibit, through policies and procedures, communications with the public from employees' home computers unless the member is capable of supervising and retaining such communications.

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- 12 See NYSE Rules 342.16 and 342.17 (Offices-Approval, Supervision and Control - Supervision of Registered Representatives and Review of Communications with the Public) and NASD Rules 2210 (Communications with the Public) and 2211 (Institutional Sales Material and Correspondence). See also NASD Rule 3010 (Supervision and NASD Rule 3010(d) (Review of Transactions and Correspondence). (NASD staff notes its intention to propose amendments to Rule 3010(d)(2) to eliminate outdated distinctions between certain hard copy and electronic communications and to reflect this Joint Guidance.)
- 13 See NASD Rules 2210 and 2211. See also NASD Guide to the Internet for Registered Representatives, available at [http://www.nasd.com/RulesRegulation/IssueCenter/Advertising/NASDW\\_006118](http://www.nasd.com/RulesRegulation/IssueCenter/Advertising/NASDW_006118). See also NYSE Rule 472(a), which requires pre-approval for any advertisement, market letter, sales literature, communication, or research report that is distributed or made available to a customer or the public by a member.
- 14 A “weblog” (often referred to as a “blog”) is a web-based publication consisting primarily of periodic reports (generally in reverse chronological order). Similar to other media, blogs often focus on particular subjects (e.g., politics) and combine text, images, and links to other blogs, web pages, and other media related topics.
- 15 “Podcasting” is a method of distributing multimedia files (i.e., audio or video content) over the Internet for playback on mobile devices and personal computers.
- 16 See Section II, page 1, of this Joint Guidance (page 3 of this Notice).
- 17 Firms should be aware that pursuant to NYSE Rule 342.10(B) and NASD Rule 3010(g)(2), employees working at their primary residences and relying on the exception from branch office registration cannot use their personal e-mail accounts to communicate with potential or existing customers from such locations; electronic communications from such locations must be made through the member’s electronic system consistent with the terms of the exception. See generally NYSE Information Memos 05-74 (October 6, 2005) and 06-13 (March 22, 2006) and *NASD Notice to Members 06-12* (March 2006).
- 18 NASD views message boards as advertisements under NASD Rule 2210, and such board postings must be approved prior to use and in writing by a registered principal. (See “Ask the Analyst About Electronic Communications,” NASD Regulatory & Compliance Alert, April 1996.)
- 19 NASD views E-faxes sent to 25 or more prospective retail customers within a 30 calendar-day period to be sales literature under NASD Rule 2210, and they must be approved prior to use and in writing by a registered principal. NASD also requires principal pre-use approval for E-faxes sent to 25 or more existing retail customers within any 30 calendar-day period that make any financial or investment recommendation or otherwise promote a product or service of the member. See *NASD Notice to Members 06-45* (August 2006).
- 20 See NYSE Information Memo 91-22 (June 28, 1991) and *NASD Notice to Members 91-45* (June 1991) (Joint NASD/NYSE Memo on Chinese Wall Policies and Procedures).
- 21 See, e.g., NASD Rules 3010(d)(1), 2210, and 2211 and NYSE Rules 342(b)(2) and 472.
- 22 Cf. *NASD Notice to Members 99-03* (January 1999) (allowing unregistered persons who have received sufficient training to review written, non-electronic correspondence).
- 23 See NYSE Rules 342(b) and 342.13 and NASD Rule 3010.
- 24 See proposed NYSE Rule 340 (Outsourcing: Due Diligence in the Use of Service Providers) at SR-NYSE-2005-22 and *NASD Notice to Members 05-48* (July 2005) (Members’ Responsibilities When Outsourcing Activities to Third-Party Service Providers).
- 25 See NYSE Information Memo No. 98-3, (January 16, 1998).
- 26 See, e.g., NASD Rules 3010(d)(1), 2210 and 2211 and NYSE Rules 342.16, 342.17, and 472.

## Disciplinary and Other NASD Actions

### REPORTED FOR JUNE

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 April 2007.

### Firms Expelled, Individuals Sanctioned

**Blacklake Securities Corporation (CRD #104128, New York, New York) and Wesley Arthur Bennett, Jr (CRD #2254995, Registered Principal, Jersey City, New Jersey).** The firm was expelled from NASD membership and Bennett was barred from association with any NASD member in any capacity. The sanctions were based on findings that the firm, acting through Bennett, engaged in proprietary transactions that required a higher minimum net capital and failed to file the required application, and receive NASD approval, to change the membership agreement under SEC Rule 15c3-1 before engaging in the proprietary transactions. The findings stated that the firm, acting through Bennett, failed to report statistical and summary information regarding customer complaints. The findings also stated that Bennett willfully failed to timely amend his Uniform Application for Securities Industry Registration or Transfer (Form U4) to disclose material facts. (NASD Case #E102004005702)

**Donner Corporation International nka National Capital Securities, Inc. (CRD #37702, Oklahoma City, Oklahoma), Jeffrey Lyle Baclet (CRD #2022409, Registered Principal, Santa Ana, California), Paul Alan Runyon (CRD #3159920, Registered Representative, Lake Forest, California).** The firm was expelled from NASD membership and Baclet was barred from association with any NASD member in any capacity. Runyon was fined \$20,000, suspended from association with any NASD member in any capacity for six months, and required to requalify by exam as a general securities representative and a general securities principal. The United States Securities and Exchange Commission (SEC) imposed the sanctions following appeal of a National Adjudicatory Council (NAC) decision. The sanctions were based on findings that the firm, acting through Baclet, issued research reports on smallcap stock issuers that failed to disclose material information and contained misleading, exaggerated and false statements. The findings stated that the firm and Baclet failed to disclose that the firm had received compensation for the preparation and issuance of research reports on the issuers' behalf. The findings also stated that the firm, through Baclet, failed to obtain

signed approval of research reports prior to their dissemination. The findings also included that the firm and Baclet failed to establish, maintain and enforce adequate written supervisory procedures reasonably designed to achieve compliance with applicable securities laws and NASD rules concerning the preparation and issuance of research reports. NASD found that Runyon issued research reports that contained material misstatements and omissions.

Runyon's suspension in any capacity is in effect from May 7, 2007, through November 6, 2007. (NASD Case #CAF20020048)

## Firms and Individuals Fined

**Anderson & Strudwick, Incorporated (CRD #48, Richmond, Virginia) and Bradley Allan Brown (CRD #3097139, Registered Principal, Richmond, Virginia)** submitted a Letter of Acceptance, Waiver and Consent in which they were censured and fined \$5,000, jointly and severally. An additional \$12,500 fine was imposed against the firm, and Brown was fined an additional \$5,000. Without admitting or denying the findings, the firm and Brown consented to the described sanctions and to the entry of findings that the firm failed to timely report municipal securities transactions to the MSRB. The findings stated that in contravention of trading restrictions in a "research analyst account," Brown effected securities transactions in accounts he owned, each of which involved securities issued by a company he followed as a research analyst. The findings also stated that the transactions were inconsistent with his recommendations as reflected in his most recent research report his member firm published. The findings also included that the firm and Brown issued research reports that did not include either price charts and price target disclosures or information directing readers in a clear manner where they could obtain applicable current disclosures in written or electronic format, and issued one firm research report that failed to include price charts and price target disclosures. NASD found that the firm failed to establish, maintain and enforce written supervisory procedures reasonably designed to achieve compliance with its trade reporting obligations and failed, in certain respects, to implement and adequately enforce its written supervisory procedures relating to NASD Rule 2711(h). (NASD Case #2006003775301)

**Bathgate Capital Partners LLC (CRD #38923, Greenwood Village, Colorado) and Steven Charles Signer (CRD #719368, Registered Principal, Boulder, Colorado)** submitted Letters of Acceptance, Waiver and Consent in which the firm was censured and fined \$50,000, and Signer was censured and fined \$15,000. Without admitting or denying the findings, the firm and Signer consented to the described sanctions and to the entry of findings that Signer sent and received electronic correspondence related to the firm's securities business using his own email provider and failed to copy the firm on all email communications. The findings stated that the firm failed to retain and preserve Signer's business-related email and to preserve all of it in a non-erasable and non-rewritable format. The findings also stated that the firm's supervisory systems and procedures were not reasonably designed to achieve compliance with SEC Rule 17a-4 since they did not adequately provide for capturing, retaining and preserving Signer's emails when he failed to copy or forward them to the firm. The findings also included that the firm failed to conduct an annual inspection of Signer's branch office pursuant to NASD Rule 3010(c) and its own written procedures. (NASD Cases #E3A2005002701/E3A2005002702)

## Firms Fined

**ACAP Financial Inc. (CRD #7731, Salt Lake City, Utah)** 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 concerning trade reporting. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit to the OTC Reporting Facility last sale reports of transactions in OTC equity securities, and failed to designate to the OTC Reporting Facility that some of the reports were late. The findings stated that the firm incorrectly designated to the OTC Reporting Facility last sale reports of transactions in OTC equity securities reported to the OTC Reporting Facility within 90 seconds of execution as ".SLD". The findings also stated that the firm failed to transmit through the OTC Reporting Facility last sale reports of transactions executed outside normal market hours in OTC equity securities and failed to designate them as ".T". 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 trade reporting, and failed to enforce its written supervisory procedures that specified that the head of trading was to indicate his review of trade reporting by initialing and dating the reviewed order tickets. (NASD Case #20060041582-01)

**A.G. Edwards & Sons, Inc. (CRD #4, St. Louis, Missouri)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$17,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that, in transactions for or with a public customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. The findings stated that the firm failed to report to the NASDAQ Market Center (NMC) the correct symbol indicating whether transactions were buy, sell, sell short, sell short exempt or cross for transactions in eligible securities. (NASD Case #20050010270-01)

**Cabrera Capital Markets, Inc. nka Cabrera Capital Markets, LLC (CRD #10081, Chicago, Illinois)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$23,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it used the mails or other means or instrumentalities of interstate commerce to effect transactions in securities when it failed to maintain the minimum required net capital. The findings stated that the firm prepared inaccurate net capital computations and filed Financial and Operational Combined Uniform Single (FOCUS) IIA Reports with NASD that were inaccurate, in that the reports overstated the firm's net capital. The findings also stated that the firm failed to give notice to the SEC on the same day that its net capital declined below the minimum amount required pursuant to SEC Rule 15c3-1. The findings also included that the firm failed to report transactions in TRACE-eligible securities to the Trade Reporting and Compliance Engine (TRACE) within 15 minutes of the execution time; reported trades already reported or there was no order ticket in connection with the reported trade; and transactions were reported with an incorrect execution time. NASD found that the firm

failed to timely report municipal securities transactions to the MSRB. (NASD Case #2006003849301)

**Coker & Palmer (CRD #29163, Jackson, Mississippi)** 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 issued research reports that did not contain any disclosures concerning the risks that might impede achievement of a price target or contained price-risk disclosures not in the required form. The findings stated that the firm issued research reports that failed to disclose the percentage of all securities the firm rated to which it had assigned a buy, hold or sell rating, and the percentage of companies within each category for which the firm had provided investment banking services within the preceding twelve-month period. (NASD Case #2006003761701)

**HSBC Brokerage (USA) Inc. (CRD #6956) nka HSBC Securities (USA), Inc. (CRD# 19585, New York, New York)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$250,000. 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 failed to establish, maintain and enforce written procedures to supervise the activities of each registered representative and associated person on the firm's Fixed Income Desk that was reasonably designed to achieve compliance with the obligation to use reasonable diligence to ascertain the best price for government securities, and thus, comply with applicable securities laws, regulations and NASD rules. The findings stated that the firm engaged in government securities transactions and failed to provide public customers with best execution so that the price the customers received was as favorable as possible under prevailing market conditions. (NASD Case #2005002337401)

**ING Financial Partners, Inc. (CRD #2882, Des Moines, Iowa)** 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 promptly forward checks processed with application way purchase transactions to issuers or to return checks to

the public customers. The findings stated that the firm's failure to promptly forward or return checks caused the firm to fail to comply with the requirements of the exemption in SEC Rule 15c3-3(k)(2)(ii), making the firm fully subject to the requirements of SEC Rule 15c3-3. The findings also stated that because the firm was operating under an exemption to the rule, it did not meet all the requirements of the rule including the requirement to maintain a Special Reserve Account for the Exclusive Benefit of Customers. (NASD Case #20060039805-01)

**Kaufman Bros., L.P. (CRD #37909, New York, New York)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$22,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to submit to the Trade Reporting Facility and to NASDAQ, for the offsetting "riskless" portion of "riskless" principal transactions in designated securities, either a clearing-only report with a capacity indicator of "riskless principal" or a "non-tape", non-clearing report with a capacity indicator of "riskless principal," and the firm double-reported some riskless principal transactions. The findings stated that the firm failed to correctly report sale transactions to the Automated Confirmation Transaction Service (ACT) as long, short or short exempt, and failed to report a transaction to ACT. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect to applicable securities laws, regulations, and NASD rules concerning order handling, best execution, anti-intimidation and coordination, trade reporting, sales transactions, the Order Audit Trail System (OATS), and books and records. (NASD Case #20060055147-01)

**McMahan Securities Co. L.P. (CRD #22123, Greenwich, Connecticut)** 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 to TRACE the correct trade execution time for transactions in TRACE-eligible securities and failed to timely report transactions in TRACE-eligible securities executed on a business day during TRACE system hours. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with respect

to applicable securities laws, regulations and NASD rules concerning TRACE reporting. (NASD Case #20050001832-01)

**Meyers Associates, L.P. (CRD #34171, 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 conducted a municipal securities business and executed municipal securities transactions without employing a properly registered municipal securities principal to supervise the firm's municipal securities activities. (NASD Case #E102003044103)

**Newbridge Securities Corp. (CRD #104065, Fort Lauderdale, Florida)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$70,000 and required to revise its written supervisory procedures concerning best execution, trade reporting, short sales and recordkeeping. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to accept or decline transactions in eligible securities in the NMC within 20 minutes after execution that the firm had an obligation to accept or decline in the NMC as the order entry identifier (OEID). The findings stated that the firm failed to execute orders fully and promptly; failed to show the terms and conditions, entry time, correct entry time, correct execution time and execution time on brokerage order memoranda. The findings also stated that the firm failed to report to the NMC the correct symbol indicating whether it executed transactions in eligible securities in a principal, riskless principal or agency capacity, and failed to report the correct unit price for transactions in eligible securities to the NMC. The findings also included that when the firm acted as principal for its own account, it failed to provide written notification disclosing to customers the correct reported trade price or that it was a market maker in the security.

NASD found that the firm made available a report on the covered orders in national market system securities it received for execution from any person that contained incorrect information as to the number of covered orders and cumulative number of shares of covered orders. NASD also found that the firm failed to make publicly available a report on its routing of non-directed

orders in covered securities during a quarter and failed to use reasonable diligence to ascertain the best inter-dealer market, and failed to buy or sell in such market so that the resultant price to its customers was as favorable as possible under prevailing market conditions.

In addition, NASD determined 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 best execution, trade reporting, short sales and recordkeeping. Moreover, NASD found that the firm failed to enforce its written supervisory procedures that specified the firm would document reviews to ensure compliance with applicable securities laws, regulations and NASD rules concerning regular and rigorous reviews and the three quote rule. Furthermore, the findings stated that the firm executed riskless principal transactions in NNM securities and incorrectly reported to the NMC that it executed the transactions in an agency capacity instead of in a principal capacity without submitting separate clearing only or non-tape, non-clearing reports with capacity indicators of "riskless principal." In addition, the findings stated that the firm executed riskless principal transactions in SmallCap Market, NNM and Over-the-Counter (OTC) equity securities, and reported to the NMC that it executed the transactions in a principal-only or agency capacity instead of in a principal capacity without submitting separate clearing only or non-tape, non-clearing reports with capacity indicators of "riskless principal." The findings also stated that the firm failed to report to the NMC the correct symbol indicating if it executed transactions in eligible securities in a principal or agency capacity; failed to report whether transactions were buy, sell, sell short, sell short exempt or cross for transactions in eligible securities; and failed to report last sale reports of transactions in NASDAQ securities through the NMC or Trade Reporting and Comparison Service (TRACS). (NASD Case #20050000811-03)

**New York Global Securities, Inc. (CRD #46429, New York, New York)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$45,000 and suspended from issuing any research reports for six months. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it prepared and issued research reports to public customers that violated NASD rules governing the content and

disclosures required for equity research reports and rules governing content standards for communications with the public. The findings stated that the reports failed to disclose the firm's actual, material conflicts of interest and failed to provide readers with a sound basis from which to evaluate a potential investment.

The suspension from issuing any research reports is in effect from May 7, 2007, through November 6, 2007. (NASD Case #E1020050319-01)

**Pacific Growth Equities, LLC (CRD #24835, San Francisco, California)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed, within 90 seconds after execution, to transmit last sale reports in NASDAQ securities to the NMC. The findings stated that the firm failed, within 90 seconds after execution, to transmit last sale reports in OTC equity securities to the OTC Reporting Facility. The findings also stated that the firm improperly reported a riskless principal trade or portion thereof as a principal trade; reported a principal trade or portion thereof as a riskless principal trade; failed to report the customer side (the second leg) of a riskless principal trade or improperly reported a trade with a .W modifier. The findings also included that the firm failed to report the correct symbol indicating whether the transaction was a buy, sell, sell short, sell short exempt or cross for transactions in eligible securities to the NMC. NASD found that the firm failed to report transactions to the NMC; submitted an inaccurate execution time; reported a principal trade as an agency trade and submitted a duplicate trade report. NASD also found that the firm failed to show the correct entry time on brokerage order memoranda and failed to maintain records pertaining to order cancellations. (NASD Case #20050017644-01)

**Raymond James Financial Services, Inc. (CRD #6694, St. Petersburg, Florida)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$12,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to record a registered representative's private transaction on its books and records. The findings stated that the firm failed to supervise the representative's participation in the transaction as if it were a firm

transaction or in a manner reasonably designed to achieve compliance with the laws, rules and regulations that applied to the registered representative's activities. (NASD Case #2005001729502)

**Sigma Financial Corporation (CRD #14303, Ann Arbor, Michigan)** 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 the offering of securities that were not registered with the SEC. The findings stated that the firm failed to adequately and properly maintain a reasonable supervisory system and written procedures to require that investors solicited through advertisement, workshops or the Web site were not offered securities that the firm was currently offering or contemplating offering at the time of the initial contact. (NASD Case #E8A2005026301)

**Stanford Group Company (CRD #39285, Houston, Texas)** 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 in connection with the firm's retail brokerage operations, it held customer funds without performing required reserve computations and making deposits into a special reserve bank account for the customers' exclusive benefit. The findings stated that the firm failed to establish and maintain a supervisory system reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules, in that it failed to provide each of its branch offices with copies of its written supervisory procedures or an equivalent document regarding the timely processing of customer checks. The findings also stated that the firm conducted a securities business while failing to maintain its required minimum net capital. (NASD Case #E062005005301)

**State Street Global Markets, LLC (CRD #30107, Boston, Massachusetts)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$100,000 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 implement an adequate supervisory system and written procedures designed to ensure that all electronic communications relating to its business as a broker-dealer are captured and retained. The findings stated that the firm's supervisory system failed to provide for effective follow-up and review or other monitoring of Instant Message (IM) usage at the firm to ensure that all IM users had properly synchronized their passwords and that all electronic communications were being retained. The findings also stated that the firm failed to maintain and preserve all business-related IM communications its registered representatives sent and received. (NASD Case #2006003803901)

**Taglich Brothers, Inc. (CRD #29102, Huntington, 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 failed to enforce its written supervisory procedures requiring annual reviews of its fee-based retail customer brokerage accounts to review the appropriateness of the compensation structure for each customer and documentation of the reasons customers choose a fee-based account. (NASD Case #ELI2005004501)

**Trend Trader, LLC (CRD #43635, Scottsdale, Arizona)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$13,000 and required to revise its written supervisory procedures with respect to NASD Rules 3110 and 3370. 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 NASDAQ SmallCap securities and for each order, failed to 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 settlement date. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with NASD Rules 3110 and 3370. (NASD Case #20050007852-01)

**White Pacific Securities, Inc. (CRD #42505, San Francisco, California)** submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$125,000. Without admitting or

denying the findings, the firm consented to the described sanctions and to the entry of findings that its compliance program as a whole was not "risk-based" when viewed in the context of the firm's business, and the geographic locations of its customers and the procedures for monitoring accounts for suspicious activity were not reasonably designed to detect such activity in light of the nature of the firm's business and its customer base. The findings stated that the firm failed to implement its anti-money laundering (AML) compliance program, in that no annual training was provided for several years and the firm did not include all information required by the Bank Secrecy Act, the regulations promulgated thereunder and its AML procedures on documentation pertaining to wire transfers and other fund transmittals. The findings also stated that the firm failed to retain all electronic communications related to the firm's business for several years, and did not have a supervisory system or written procedures reasonably designed to detect and prevent failures to retain required communications. The findings also included that the firm's supervisory system and written supervisory procedures, and its enforcement thereof, were not reasonably designed to achieve compliance with applicable laws, rules and regulations regarding the payment of transaction-based compensation to foreign finders; compliance with the requirement to conduct an annual compliance interview with each registered representative; providing account records to customers when an account is opened and at specified intervals thereafter; compliance with SEC Rule 17a-3(a)(6) concerning the completeness of order memoranda; conducting required reviews for compliance with "best execution" requirements; marking order memoranda to identify discretionary transactions; and compliance with NASD rules pertaining to communications with the public in light of the various methods and languages the firm's representatives use in such communication.

NASD found that the firm paid transaction-related compensation to a foreign entity not registered as a broker-dealer and permitted its affiliated individuals who handled the referral business to function as firm representatives without registration. NASD also found that the firm met some, but not all, of the conditions in NASD Rule 1060(b) for such payments to be permissible. (NASD Case #E0120040096-02)

## Individuals Barred or Suspended

**James Wayne Alldredge (CRD #2621727, Registered Principal, Austin, Texas)** submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Alldredge consented to the described sanction and to the entry of findings that he borrowed money from public customers while registered with a member firm. The findings stated that Alldredge submitted false and misleading documentation to his member firm concerning variable annuity switch transactions, in which he concealed the fact that the funds for the new annuity purchase were the proceeds of the liquidation of an existing variable annuity, and failed to process the transactions as Section 1035 exchanges. The findings also stated that Alldredge failed to respond to an NASD request to give testimony. (NASD Case #2006005317101)

**Richard Michael Alvino (CRD #4256389, Registered Representative, San Diego, California)** 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 four months. The fine must be paid before Alvino reassociates with any NASD member following the suspension, or before his firm requests relief from any statutory disqualification. Without admitting or denying the findings, Alvino consented to the described sanctions and to the entry of findings that he participated in a private securities transaction without prior written notice to his member firm. The findings stated that Alvino failed to amend his Form U4 to disclose material information.

The suspension in any capacity is in effect from May 7, 2007, through September 6, 2007. (NASD Case #20050026837-01)

**Michael Lawrence Baldwin (CRD #1966870, Registered Principal, Kansas City, Missouri)** submitted an Offer of Settlement in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for six months. Without admitting or denying the allegations, Baldwin consented to the described sanctions and to the entry of findings that he recommended and effected excessive and unsuitable transactions in a public customer's account

without reasonable grounds for believing the transactions were suitable in light of the customer's financial situation and needs. The findings stated that Baldwin, as a registered options principal for his member firm, failed to approve options tickets before they were submitted to the clearing firm for execution, and failed to ensure that options transactions were appropriate for the customer accounts.

The suspension in any capacity is in effect from May 7, 2007, through November 6, 2007. **(NASD Case #E0420030367-01)**

**Keith Anthony Bell (CRD #2210134, Registered Representative, Pembroke Pines, 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 three months. The fine must be paid before Bell reassociates with any NASD member following the suspension, or before his firm requests relief from any statutory disqualification. Without admitting or denying the findings, Bell consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Forms U4.

The suspension in any capacity is in effect from May 7, 2007, through August 6, 2007. **(NASD Case #2006005179101)**

**Francis Bart Bertholic Jr. (CRD #1841812, Registered Principal, Liberty Lake, Washington)** submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Bertholic consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior notice to, or approval from, his member firm. The findings stated that Bertholic received \$435,000 from public customers to purchase a promissory note from which the proceeds were to be invested in real estate or to maintain and improve real property and, instead, Bertholic used the funds for his personal benefit. The findings also stated that Bertholic published newspaper advertisements, a brochure and a flier, and developed a Web site that did not disclose his firm's name and were not approved by a registered principal of the firm. The findings also included that the brochure and Web site did not provide a balanced discussion of the risks involved in real estate lending; did not disclose risks and contained false,

exaggerated, unwarranted and/or misleading statements. NASD found that the Web site presented testimonials from purported customers who, in fact, had never transacted any business with Bertholic. **(NASD Case #2006004272701)**

**Christopher Joseph Carter (CRD #3024491, Registered Representative, Anthem, Arizona)** 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, Carter consented to the described sanction and to the entry of findings that he failed to complete an NASD on-the-record interview. **(NASD Case #2005003341201)**

**Nancy Ky Cheng (CRD #2592401, Registered Representative, West Paterson, New Jersey)** submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$2,500 and suspended from association with any NASD member in any capacity for 20 business days. The fine must be paid before Cheng reassociates with any NASD member, or before her firm requests relief from any statutory disqualification. Without admitting or denying the findings, Cheng consented to the described sanctions and to the entry of findings that she engaged in an outside business activity without providing prompt written notice to her member firm.

The suspension in any capacity is in effect from May 21, 2007, through June 18, 2007. **(NASD Case #2006003840801)**

**Jacob Roman Chudzinski (CRD #1489143, Registered Representative, Freemont, Ohio)** submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Chudzinski consented to the described sanction and to the entry of findings that he received \$896,000 from public customers for investment purposes and instead, deposited the funds into an account under his control and converted the funds to his own use and benefit. **(NASD Case #2005002552101)**

**Carl Thomas Cirillo (CRD #1321207, Registered Representative, Huntington, New York)** submitted an Offer of Settlement in which he was fined \$12,000 and suspended from association with any NASD

member in any capacity for 60 days. The fine must be paid before Cirillo reassociates with any NASD member following the suspension. Without admitting or denying the allegations, Cirillo consented to the described sanctions and to the entry of findings that he employed fraudulent sales practices when, in a private placement, he recommended and sold to public customers units of a company that had minimal assets and no business operations and was owned and controlled by his family member. The findings stated that Cirillo guaranteed a customer against loss.

The suspension in any capacity is in effect from May 21, 2007, through July 19, 2007. (NASD Case #20050000286-03)

**Charles James Cuozzo Jr. (CRD #3123060, Registered Representative, Verona, New Jersey)** was fined \$5,000, suspended from association with any NASD member in any capacity for one year and required to requalify by exam as a general securities representative. The NAC imposed the sanctions following a call for review of an Office of Hearing Officers (OHO) decision. The sanctions were based on findings that Cuozzo falsified dates on numerous Regulation 60 annuity replacement forms and inserted a false statement on a public customer's Regulation 60 annuity replacement form, which resulted in the falsification of a firm document.

The suspension in any capacity is in effect from May 7, 2007, through May 6, 2008. (NASD Case #C9B20050011)

**Evan Kyle Davis (CRD #2995789, Registered Representative, Mableton, Georgia)** submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the findings, Davis consented to the described sanctions and to the entry of findings that he executed securities transactions in a public customer's account without the customer's prior knowledge, authorization or consent.

The suspension in any capacity was in effect from May 21, 2007, through June 4, 2007. (NASD Case #2006007384001)

**Joe Desoto (CRD #2879888, Associated Person, Kissimmee, Florida)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Desoto willfully failed to disclose material facts on his Form U4 and failed to respond to NASD requests for information. (NASD Case #2006004240501)

**Robert John Ellis (CRD #2671864, Registered Principal, Austin, Texas)** submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$56,650—which includes \$46,650 in disgorgement of commissions—and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Ellis reassociates with any NASD member following the suspension, or before his firm requests relief from any statutory disqualification. Without admitting or denying the findings, Ellis consented to the described sanctions and to the entry of findings that he engaged in private securities transactions without providing prior written notice to, or receiving written approval from, his member firm describing in detail the proposed transactions, his role therein, and stating whether he had received or might receive selling compensation in connection with the transactions.

The suspension in any capacity is in effect from April 16, 2007, through April 15, 2008. (NASD Case #2006003679801)

**Jamin Marlowe Epstein (CRD #1897974, Registered Representative, Wexford, Pennsylvania)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Epstein made false representations regarding disbursements from public customers' variable annuity policies. The findings stated that Epstein failed to respond to NASD requests to provide testimony. (NASD Case #2005003508101)

**Ruben Guillermo Fernandez (CRD #206736, Registered Representative, Tucson, Arizona)** 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 Fernandez reassociates with any NASD member following the suspension, or before his firm requests

relief from any statutory disqualification. Without admitting or denying the findings, Fernandez consented to the described sanctions and to the entry of findings that he effected trades on a discretionary basis in public customer accounts without prior written authorization from the customers to exercise discretion, and without obtaining his member firm's written acceptance of the accounts as discretionary.

The suspension in any capacity was in effect from May 21, 2007, through June 4, 2007. (NASD Case #2006005614601)

**Paul Elliott Katz (CRD #702523, Registered Representative, Houston, Texas)** submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the findings, Katz consented to the described sanctions and to the entry of findings that he effected securities transactions in public customers' accounts through the use of discretionary power without the customers' prior written authorization and without his member firm's acceptance in writing of the accounts as discretionary.

The suspension in any capacity was in effect from May 7, 2007, through May 18, 2007. (NASD Case #2005002589901)

**Alexis Casimir Korybut (CRD #2361771, Registered Principal, Coconut Grove, Florida)** submitted an Offer of Settlement in which he was fined \$25,000, suspended from association with any NASD member in any capacity for 15 business days and suspended from association with any NASD member in any principal capacity for 60 days. The fine must be paid before Korybut reassociates with any NASD member following the 15 business-day suspension in any capacity, or before his firm requests relief from any statutory disqualification. Without admitting or denying the allegations, Korybut consented to the described sanctions and to the entry of findings that, while acting on his member firm's behalf, he failed to ensure that his firm complied with an independent consultant's recommendations to remedy the deficiencies identified in the firm's prior settlements. The findings stated that Korybut, while acting on his member firm's behalf, failed to implement the various procedures

recommended in the consultant's reports; failed to establish and implement adequate systems and procedures for monitoring the activities of the firm's producing branch managers who approved account documentation and reviewed account activity and correspondence for their own customer accounts; failed to designate a registered principal as an office of supervisory jurisdiction (OSJ) supervisor; failed to establish and implement procedures for monitoring activities such as excessive "cancels and rebills" that might serve as "red flags" for detecting possible unauthorized transactions; and failed to establish procedures in an OSJ for ensuring a registered principal reviewed outgoing and incoming branch correspondence.

The suspension in any capacity was in effect from May 7, 2007, through May 25, 2007. The suspension in any principal capacity is in effect from May 7, 2007, through July 5, 2007. (NASD Case #E072004002301)

**Darrell Craig Lerner (CRD #4525134, Registered Representative, Great Neck, New York)** submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Lerner consented to the described sanction and to the entry of findings that, while registered with his member firm, he did not conduct any firm business but parked his license with the firm. The findings stated that Lerner engaged in outside business activities and private securities transactions while his license was parked. The findings also stated that Lerner failed to disclose a material fact on his Form U4 and provided false testimony under oath during an NASD on-the-record interview. (NASD Case #2005000440701)

**Samuel Yungkong Liu (CRD #704382, Registered Representative, Honolulu, Hawaii)** 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, Liu 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 prior written approval from, his member firm. The findings stated that Liu failed to appear for an NASD on-the-record interview. (NASD Case #2006005810101)

**Woody Bernard Margozewitz (CRD #1722053, Registered Representative, Boerne, Texas)** submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for five business days. Without admitting or denying the findings, Margozewitz consented to the described sanctions and to the entry of findings that he effected discretionary transactions in a public customer's account without the customer's prior written authorization to utilize discretion and without his member firm's prior written acceptance of the account as discretionary.

The suspension in any capacity was in effect from May 7, 2007, through May 11, 2007. (NASD Case #E062003014001)

**Erik Joseph Matz (CRD #2715303, Registered Representative, Hicksville, New Jersey)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Matz engaged in churning and excessive trading in public customer accounts. (NASD Case #CLI20050014)

**Phillip Earl Nelson (CRD #4157430, Registered Principal, Grovetown, Georgia)** submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 60 days. The fine must be paid before Nelson reassociates with any NASD member following the suspension, or before his firm requests relief from any statutory disqualification. Without admitting or denying the findings, Nelson consented to the described sanctions and to the entry of findings that he submitted a handwritten note to a public customer in which he made a false, exaggerated, unwarranted and/or misleading claim and an impermissible performance prediction or projection regarding a variable annuity he recommended to the customer.

The suspension in any capacity is in effect from May 21, 2007, through July 19, 2007. (NASD Case #2006004829701)

**Fredric Joseph Palmieri (CRD #3221649, Registered Representative, Marlton, New Jersey)** submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Palmieri consented to the described sanction and to the entry of findings that he knowingly submitted a false

claim to an insurance company requesting payment for the theft of his automobile when he was aware that the vehicle had not been stolen. (NASD Case #2006005437501)

**Christine Nicole Parma (CRD #4434674, Registered Representative, Portland, Oregon)** 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 six months. The fine must be paid before Parma reassociates with any NASD member following the suspension, or before her firm requests relief from any statutory disqualification. Without admitting or denying the findings, Parma consented to the described sanctions and to the entry of findings that she participated in a private securities transaction without prior written notice to, and approval from, her member firm.

The suspension in any capacity is in effect from May 21, 2007, through November 20, 2007. (NASD Case #20060056070-01)

**Tsewang Tenzing Pemba (CRD #1932236, Registered Representative, Sunnyside, 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 six months. The fine must be paid before Pemba reassociates with any NASD member following the suspension, or before his firm requests relief from any statutory disqualification. Without admitting or denying the findings, Pemba consented to the described sanctions and to the entry of findings that he participated in private securities transactions without providing his member firm with written notice describing in detail the proposed transaction and his role therein.

The suspension in any capacity is in effect from May 7, 2007, through November 6, 2007. (NASD Case #2005001886602)

**Michael James Resciniti (CRD #4006304, Registered Representative, Sound Beach, New York)** submitted an Offer of Settlement in which he was fined \$5,000, suspended from association with any NASD member in any capacity for 10 business days and required to pay \$10,842.03, plus interest, in restitution to a public customer. Satisfactory proof of payment of restitution or of reasonable and documented efforts undertaken to effect restitution must be provided to NASD. Without

admitting or denying the allegations, Resciniti consented to the described sanctions and to the entry of findings that he effected, or caused to be effected, transactions in a public customer's account without the customer's prior knowledge, authorization or consent.

The suspension in any capacity was in effect from May 21, 2007, through June 4, 2007. (NASD Case #ELI20030562-01)

**James Everett Robson Jr. (CRD #2456030, Registered Representative, Waxhaw, North Carolina)** submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the findings, Robson consented to the described sanction and to the entry of findings that he signed a deceased customer's name to multiple Individual Retirement Account (IRA) distribution request forms and checks without the knowledge and consent of the customer or his widow. The findings stated that after forging the customer's signature, Robson made checks totaling \$31,240 payable to himself and deposited the funds into his personal bank account without the customer's or his widow's knowledge or authorization, thereby converting the customer's funds. The findings also stated that Robson failed to respond to NASD requests for information. (NASD Case #2006005364001)

**James Young Shin (CRD #3192988, Registered Representative, Rosemount, 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 30 business days. The fine must be paid before Shin reassociates with any NASD member following the suspension, or before his firm requests relief from any statutory disqualification. Without admitting or denying the findings, Shin 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 April 16, 2007, through May 25, 2007. (NASD Case #20060056863-01)

**Rufino T. Singson Sr. (CRD #2025299, Registered Representative, Hicksville, 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, Singson consented to the described sanction and to the entry of findings that he participated in private securities transactions without providing written notice to his member firm describing in detail the proposed transaction and his role therein. The findings stated that Singson refused to respond to questions during an NASD on-the-record interview. (NASD Case #2005001886601)

**Maureen Catherine Sullivan (CRD #2192738, Registered Representative, Chattanooga, Tennessee)** was barred from association with any NASD member in any capacity. The sanction was based on findings that Sullivan willfully failed to disclose material information on her Form U4. The findings stated that Sullivan failed to respond to NASD requests to appear for an on-the-record interview. (NASD Case #2005002129901)

**Plase Michael Tansil (CRD #2317768, Registered Representative, Murfreesboro, Tennessee)** 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, Tansil consented to the described sanction and to the entry of findings that he made an improper guarantee to public customers, misused customer funds to cover a shortfall regarding the guarantee, made material misrepresentations to customers that their funds would be used for investment purposes, and settled a customer complaint without his member firm's knowledge or consent. (NASD Case #2005002229201)

**Alison Esther Taylor (CRD #1871817, Registered Principal, McDonough, Georgia)** 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 principal capacity for 15 business days. Without admitting or denying the findings, Taylor consented to the described sanctions and to the entry of findings that she failed to reasonably and adequately supervise registered representatives who violated various provisions of NASD Rule 2210 and SEC Rule 482 in their communications with the public. The findings stated that Taylor approved some of the communications. The findings also stated that Taylor failed to reasonably and adequately supervise a registered representative with respect to a customer complaint for a loss relating to an investment that the representative settled away from

the firm, and Taylor failed to create a written record that there was a problem with the account or to follow-up with the representative prior to his decision to send a letter to the customer and make payment to the customer directly. The findings also included that neither Taylor nor the representative notified the firm of the issue before payment was made and the letter was sent.

The suspension in any principal capacity was in effect from May 21, 2007, through June 11, 2007. (NASD Case #E0420040369-04)

**Marylan Katherine Taylor (CRD #2263196, Registered Representative, Aurora, Ohio)** was barred from association with any NASD member in any capacity. The NAC imposed the sanction following appeal of an OHO decision. The sanction was based on findings that Taylor submitted falsified documents to the insurance division of a state regulator that represented that her insurance licenses were in good standing when in fact they were inactive due to her failure to complete continuing education. The findings stated that Taylor failed to timely amend her Form U4 to disclose material information. The findings also stated that Taylor failed to respond truthfully during an NASD on-the-record interview. (NASD Case #C8A20050027/E8B20030292)

**Steven John Windstein (CRD #5181082, Associated Person, West Chester, Pennsylvania)** 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 three months. The fine must be paid before Windstein reassociates with any NASD member following the suspension, or before his firm requests relief from any statutory disqualification. Without admitting or denying the findings, Windstein consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information in his Form U4.

The suspension in any capacity is in effect from May 7, 2007, through August 6, 2007. (NASD Case #2006006320001)

**Terrance Yutaka Yoshikawa (CRD #474700, Registered Principal, Seattle, Washington)** was barred from association with any NASD member in any capacity. The SEC imposed the sanction following appeal of a NAC decision. The sanction was based on findings that Yoshikawa repeatedly engaged in manipulative trading practices that included trades

fraudulently designed to improve the national best bid or offer (NBBO) price for the purpose of enabling Yoshikawa to obtain execution of orders on the opposite side of the market at the NBBO prices he created. (NASD Case #CMS020247/ 2004200000202)

## Individual Fined

**Arnold Ira Roseman (CRD #500276, Registered Principal, Boca Raton, Florida)** submitted a Letter of Acceptance, Waiver and Consent in which he was censured and fined \$15,000. Without admitting or denying the findings, Roseman consented to the described sanctions and to the entry of findings that he failed to establish and maintain a supervisory system and written supervisory procedures reasonably designed to achieve compliance with his member firm's obligation to preserve electronic communications related to its business. The findings stated that Roseman failed to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the firm's obligation to conduct an annual inspection of each Office of Supervisory Jurisdiction, to supervise the activities of each registered representative, in that the firm's procedures did not address the circumstances that would warrant heightened supervision of a representative after the representative was hired, and to amend its registered persons' Forms U4 if the information previously provided became inaccurate. The findings also stated that Roseman did not evaluate and prioritize the firm's training needs or develop a training plan. (NASD Case #E072004005002)

## Decision Issued

The following decision has been issued by the OHO and has been appealed to or called for review by the NAC as of April 30, 2007. 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 *Notices to Members*.

**Carl Martin Trevisan (CRD #715623, Registered Representative, Alexandria, Virginia)** and **Edward Martin VanGrouw (CRD #1032559, Registered Representative, Fairlawn, New Jersey)**. Trevisan was

barred from association with any NASD member in any capacity. VanGrouw was fined \$20,000, suspended from association with any NASD member in any capacity for two years and ordered to requalify by exam before again serving in any registered capacity. The sanctions were based on findings that Trevisan and VanGrouw obtained contingent deferred sales charge (CDSC) waivers for customers selling Class B mutual fund shares by falsely claiming that the customers were disabled although they were not. The findings stated that Trevisan, in connection with the mutual fund redemptions, represented on his member firm's electronic order system that the customers were disabled.

This decision has been appealed to the NAC, and the sanctions are not in effect pending consideration of the appeal. (NASD Case #E9B2003026301)

## 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.

**Tony Nathan Cota (CRD #4147725, Registered Representative, Clovis, California)** was named as a respondent in an NASD complaint alleging that he entered into a personal loan with a public customer in violation of NASD Rule 2370 and his member firm's written policies, and concealed the loan from his firm on a representative questionnaire. The complaint alleges that Cota caused \$9,615.39 to be withdrawn from a customer's variable annuity account, and \$7,500 to be transferred and deposited into the customer's checking account without her knowledge, authorization or consent, thereby misusing customer funds. The complaint also alleges that Cota failed to respond to NASD requests for information and to appear for an on-the-record interview. (NASD Case #20060043565-01)

**Richard Wayne Mentz Jr. (CRD #2150829, Registered Principal, Scottsdale, Arizona)** was named as a respondent in an NASD complaint alleging that he provided a public customer with new account and margin account documents to sign that contained inaccurate financial information, including the customer's net worth, and mis-stated the customer's investment objectives. The complaint alleges that Mentz executed transactions in the customer's account that were excessive in number and frequency, and the purchases were made with the use of margin and were unsuitable in light of the customer's financial situation and needs, his investment objectives and his other security holdings. The complaint also alleges that Mentz, directly or indirectly, by the use of the means or instrumentalities of interstate commerce or of the mails, knowingly or recklessly used or employed, in connection with the purchase or sale of securities, manipulative or deceptive devices or contrivances; and knowingly or recklessly effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive or other fraudulent devices or contrivances. (NASD Case #2005001087801)

**Joey N. Perez (CRD #4739449, Registered Representative, Houston, Texas)** was named as a respondent in an NASD complaint alleging that as a bank service representative, he serviced a public customer and issued him a bank debit card. The complaint alleges that Perez issued a second debit card to the customer's wife without either of their knowledge or authorization. The complaint also alleges that instead of giving the debit card to the customer or his wife, Perez maintained possession of it and gave the card to an acquaintance unrelated to the customer who subsequently used the card on numerous occasions, resulting in unauthorized aggregate withdrawals of \$13,744. The complaint further alleges that Perez failed to respond to NASD requests for information. (NASD Case #2006005690401)

**Jeffrey Charles Plunkett (CRD #2731884, Registered Principal, Tulsa, Oklahoma)** was named as a respondent in an NASD complaint alleging that he drew checks against accounts public customers owned, forged the customers' signature on the checks and cashed the checks without the customers' authorization, knowledge or consent, thereby converting \$539,252 to his own use and benefit. The complaint alleges that Plunkett transferred \$73,189 from one public customer's

account to another customer's account without the first customer's authorization, knowledge or consent. The complaint also alleges that Plunkett failed to respond to NASD requests for information. **(NASD Case #2005003235201)**

**David Alexander Ricca (CRD #3202131, Registered Representative, Clifton, New Jersey)** was named as a respondent in an NASD complaint alleging that he received \$25,000 in loans from a public customer in contravention of his member firm's written procedures, which prohibited employees from borrowing or lending money to customers. The complaint alleges that Ricca received \$25,000 from customers for investment purposes, documented the receipt of the funds as a loan to him, failed to apply these funds as directed, and converted the funds for his own use and benefit. The complaint also alleges that Ricca failed to respond to NASD requests for information and documents. **(NASD Case #2006004672701)**

**Todd William Sens (CRD #2558107, Registered Representative, Robbinsdale, Minnesota)** was named as a respondent in an NASD complaint alleging that he received \$3,528.60 from a public customer to pay life insurance premiums and instead used the funds for his personal benefit, thereby converting the funds for the purchase of non-securities products. The complaint alleges that Sens failed to respond to NASD requests for information. **(NASD Case #20060050165-01)**

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

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

**Hunting Party Securities, Ltd.**  
Stamford, Connecticut  
(April 18, 2007)

**NMP Capital, LLC**  
Kansas City, Missouri  
(April 18, 2007 – April 27, 2007)

**Seaway Investment Company, Inc.**  
Muskegon, Michigan  
(April 18, 2007)

**Starboard Capital Markets, LLC**  
Moorestown, New Jersey  
(April 18, 2007)

**Windship Capital Markets, LLC**  
Atlanta, Georgia  
(April 18, 2007)

### **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.)

**Great Eastern Securities, Inc.**  
New York, New York  
(April 5, 2007)

### **Firm Suspended Pursuant to NASD Rule 9553 for Failure to Pay Arbitration Fees**

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

**Solomon Advisors**  
Dallas, Texas  
(April 16, 2007 – April 27, 2007)

### **Individuals Suspended Pursuant to NASD Rule 9553 for Failure to Pay Arbitration Fees**

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

**Jeffrey Matthew Jenovese**  
Heathrow, Florida  
(April 23, 2007)

**Jeffrey Allan Mascio**  
Highlands Ranch, Colorado  
(October 9, 2006 – April 24, 2007)

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

**Patrick Alexander Anthony**  
Los Angeles, California  
(April 23, 2007)

**James Edward Cleary Jr.**  
Aventura, Florida  
(April 23, 2007)

**Individuals Barred Pursuant to NASD Rule 9552(h)**

**Christopher Mark Ostoich**  
Ft. Wright, Kentucky  
(April 2, 2007)

**Jon Manuel Palacios**  
San Bernardino, California  
(April 4, 2007)

**Cass Lamar Weldon**  
Bossier City, Louisiana  
(April 5, 2007)

**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 Edward Armentrout**  
Washington, DC  
(April 2, 2007)

**Eric James Brown**  
Highland Beach, Florida  
(April 24, 2007)

**Shawn Clay**  
Charlevoix, Michigan  
(April 16, 2007)

**Michael L. Donaldson**  
Jamaica, New York  
(August 29, 2006 – April 16, 2007)

**Sherman Edd Douglas**  
Mobile, Alabama  
(April 23, 2007)

**James Jameke Eady**  
Brooklyn, New York  
(April 9, 2007)

**Charles Stephen Farrell III**  
Charlotte, North Carolina  
(November 29, 2006 – April 16, 2007)

**Nicholas David Glogovac**  
Los Angeles, California  
(April 9, 2007)

**Angel R. Gomez**  
SW Ranches, Florida  
(April 9, 2007)

**Matthew Jason Hamm**  
Spartanburg, South Carolina  
(September 20, 2006 – April 16, 2007)

**Calvin L. Kelle**  
Quincy, Illinois  
(April 17, 2007)

**Alethea Outing Ramey**  
Charlotte, North Carolina  
(April 30, 2007)

**William Earl Rice Jr.**  
Humble, Texas  
(December 18, 2006 – April 16, 2007)

**Lewis Taylor Smith**  
Tucson, Arizona  
(December 6, 2006 – April 16, 2007)

**Deanna Louise Snodgrass**  
Tucson, Arizona  
(April 24, 2007)

**Lori Elizabeth Zoval**  
Stateline, Nevada  
(April 9, 2007)

**Individuals Suspended Pursuant to NASD Rule 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.)

**Vladimir Alexeyvich Belinsky**  
Orinda, California  
(April 16, 2007)

**Carl Edward Cherasia**  
Toms River, New Jersey  
(April 12, 2007)

**Gary Dean Dennington**  
Overland Park, Kansas  
(April 2, 2007)

**Antonio Maximiliano Duarte**  
Los Angeles, California  
(April 20, 2007)

**Izaiil Ezekiel Fields**  
Brooklyn, New York  
(April 2, 2007)

**Jared Evan Fink**  
Coral Springs, Florida  
(April 2, 2007)

**Francisco Galvan**  
Stockton, California  
(April 2, 2007)

**Mark Goldberg**  
Middle Village, New York  
(April 20, 2007)

**Melissa Ann Holovach**  
Tampa, Florida  
(April 12, 2007)

**Patrick Robert Kelley**  
Sacramento, California  
(April 27, 2007)

**Manuel Andres Larenas**  
Altamonte Springs, Florida  
(April 2, 2007)

**Robert Thomas Loftin III**  
Tinley Park, Illinois  
(April 13, 2007)

**Glenn S. Lorantas**  
Yardley, Pennsylvania  
(April 12, 2007)

**Luis Gabriel MacDonna**  
Mount Vernon, New York  
(April 2, 2007)

**Radion Felitivich Medvedosky**  
Brooklyn, New York  
(April 2, 2007)

**Franklyn Ross Michelin**  
Boca Raton, Florida  
(April 2, 2007)

**Kyle Browning Rowe**  
Dallas, Texas  
(April 27, 2007)

**Robert John Vitale**  
Parkland, Florida  
(April 2, 2007)

**Vincent John Zerbo**  
Staten Island, New York  
(April 2, 2007)

## **NASD Hearing Panel Sanctions Former Knight Securities Executives for Supervisory Failures in Connection with Fraudulent Sales**

**Former CEO Fined, Suspended; Former Sales Desk Head Fined, Barred as Supervisor**

An NASD Hearing Panel issued \$100,000 fines against Kenneth Pasternak, former CEO of Knight Securities, L.P. (now known as Knight Equity Markets, L.P.), and John Leighton, former head of the firm's Institutional Sales Desk, for supervisory violations in connection with fraudulent sales to institutional customers in 1999 and 2000.

In addition, Pasternak was suspended in all supervisory capacities for two years, while Leighton was barred in all supervisory capacities.

In March 2005, NASD's Department of Market Regulation charged Pasternak and Leighton with failure to supervise the firm's leading institutional sales trader, Joseph Leighton, who is John Leighton's brother. The NASD complaint also charged Pasternak with failing to establish and enforce a supervisory system designed to ensure compliance with federal securities laws and NASD rules

In a 2-1 ruling, the panel found that Pasternak and John Leighton failed to supervise Joseph Leighton's trading activities. "For all intents and purposes, Joseph Leighton ran the Institutional Sales Department as he saw fit," the majority ruling says. "Pasternak, John Leighton, and Joseph Leighton each concluded that as long as the customers did not learn of the extraordinary profits Knight earned on their orders, there was no limit to the amount the firm could make on an institutional order."

The majority also found that Pasternak's response to numerous red flags was "woefully inadequate," that Pasternak and John Leighton "never questioned Joseph Leighton's activities or confirmed he was providing his customers with best execution and a fair price," and that the overall supervisory void "allowed Joseph Leighton to take advantage of his customers over a 21-month period by filling orders at prices that netted Knight unreasonably high profits."

In April 2005, Joseph Leighton agreed to a bar from the securities industry and a payment of more than \$4 million to settle charges by the Securities and Exchange

Commission (SEC) and NASD that he made millions of dollars in fraudulent trades with Knight's institutional customers. The SEC and NASD found that Joseph Leighton generated excessive profits by pricing trades with institutional customers in a manner contrary to customers' expectations and industry custom, and using deceptive trading practices to disguise both his pricing and the amount of Knight's profits.

In December 2004, Knight paid more than \$79 million to settle SEC and NASD charges against the firm arising from Joseph Leighton's fraudulent and deceptive conduct.

More than \$3.3 million of Joseph Leighton's monetary sanction and more than \$66 million of the firm's monetary sanction was paid into a Fair Fund established by the SEC to compensate investors harmed by Joseph Leighton's fraud.

Pasternak appealed to the NAC on May 3, 2007.

## **NASD and Chicago Stock Exchange Fine and Suspend Traders for Cross-Market Manipulation**

**Traders Artificially Increased Price of Stock in Two Markets**

Following a joint investigation, NASD and the Chicago Stock Exchange (CHX) announced fines and suspensions against two traders for artificially inflating the price of the stock of Material Science Corporation (MSC), a New York Stock Exchange-listed company, in connection with MSC's repurchase of its stock.

NASD imposed a \$25,000 fine and a three-month suspension on Klaus Offenbacher, a trader with NASD-registered First Analysis Securities Corporation of Chicago. Offenbacher is receiving credit for a 60-day suspension already imposed by his employing firm. Officials at First Analysis Securities detected the cross-market manipulation on the date it occurred and thereafter reported it to NASD.

CHX imposed a \$20,000 fine and a two-month suspension on Bruce Kaminski, a floor broker with Dougall & Associates of Chicago, a CHX Participant firm.

Neither MSC, First Analysis Securities Corporation nor Dougall & Associates had knowledge that Offenbacher and Kaminski planned to artificially increase the price of MSC stock.

“Increasingly, trading volume is dispersed across multiple markets, with actions on each market affecting prices on the other markets,” said Thomas Gira, NASD Executive Vice President for Market Regulation. “The cooperation between the Chicago Stock Exchange and NASD on this matter demonstrates our ability and willingness to detect and investigate improper cross-market activities.”

“By working together, NASD and the Chicago Stock Exchange were able to discipline all the responsible individuals,” said CHX Chief Regulatory Officer David Whitcomb. “This type of cooperation is essential in our increasingly connected markets.”

The regulators’ joint investigation found that Offenbacher was responsible for repurchasing MSC stock on the issuer’s behalf pursuant to the company’s stock repurchase program. MSC wanted its repurchases to fall within the safe harbor provision of the Securities and Exchange Commission’s (SEC) rule governing issuer buy-backs, which provides that issuer purchases cannot be the opening purchase of the day and cannot exceed the highest independent bid or last independent transaction price.

The regulators found that on August 21, 2006, Offenbacher received authorization from MSC to repurchase 100,000 shares of MSC stock pursuant to the repurchase program. The same day, Offenbacher located an institutional customer willing to sell a 174,300-share block of MSC stock with a limit price of \$9.90. Later that day, Offenbacher attempted to contact the principals of MSC to get approval to purchase the entire block. MSC stock closed that day at a price of \$9.80 per share. Early the following day, Offenbacher received approval from MSC’s principals to purchase the block at \$9.90 per share. Before the market opened, Offenbacher directed Kaminski to purchase 1,000 shares of MSC stock at \$9.90 per share, in the event MSC opened below \$9.90 per share. When MSC opened at \$9.75 per share, Kaminski executed the 1,000 share transaction at \$9.90 per share which artificially drove the stock’s price up 15 cents to the level Offenbacher needed to execute the cross trade.

Kaminski’s execution of the 1,000-share transaction on the New York Stock Exchange established an artificial reference price at which the larger block transaction was then executed on the CHX. As a result, the regulators found that Offenbacher and Kaminski knowingly and intentionally artificially increased the market price of MSC stock in an attempt to make it appear that the purchase fell within the SEC’s safe harbor provision for issuer buy-backs.

In settling this matter, Offenbacher neither admitted nor denied the charges, but consented to the entry of NASD’s findings that his conduct violated NASD’s anti-fraud rule and other NASD rules. Similarly, Kaminski neither admitted nor denied the charges, but consented to the entry of the CHX’s findings that his conduct violated the CHX’s anti-fraud rule and other CHX rules.

Offenbacher’s suspension in any capacity was in effect from April 16, 2007, through May 15, 2007.

