

Notices

Regulatory Notices

- 07-52** SEC Approves FINRA Membership Waive-In Process for Certain NYSE Member Organizations; **Effective Date: October 12, 2007**
- 07-53** SEC Approves New NASD Rule 2821 Governing Deferred Variable Annuity Transactions; **Effective Date: May 5, 2008**
- 07-54** SEC Approves New NASD Rule 2290 Regarding Fairness Opinions; **Effective Date: December 8, 2007**
- 07-55** FINRA Reminds Member Firms of Their Obligations Regarding Background Investigations of Prospective Personnel
- 07-56** Securities Industry/Regulatory Council on Continuing Education Issues Firm Element Advisory Update
- 07-57** SEC Approves a Proposed Rule Change Relating to Representation of Parties in Arbitration and Mediation; **Effective Date: December 24, 2007**
- 07-58** FINRA Solicits Comments on Proposed Guidance Regarding International Prime Brokerage Practices; **Comment Period Expires: January 10, 2008**

Election Notice

- 11/01/07** FINRA Small Firm Advisory Board Election

Information Notice

- 11/26/07** Continuing Education Planning

Disciplinary and Other FINRA Actions

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Mandatory FINRA Membership for NYSE Member Organizations

SEC Approves FINRA Membership Waive-In Process for Certain NYSE Member Organizations

Effective Date: October 12, 2007

Executive Summary

The SEC has approved NASD IM-1013-1, which establishes a waive-in application process for FINRA membership for certain NYSE-only member organizations that must become FINRA members as a result of NYSE's new mandatory FINRA membership requirement. The SEC also approved a membership application fee waiver for firms that become FINRA members pursuant to NASD IM-1013-1.

Questions concerning this *Notice* should be directed to:

- Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104;
- Philip A. Shaikun, Associate Vice President and Associate General Counsel, OGC, at (202) 728-8451;
- Jeffrey M. Pasquerella, Deputy District Director, District 10, at (212) 858-4163; or
- Erika L. Lazar, Senior Attorney, OGC, at (212) 656-4591.

November 2007

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal
- Registration
- Senior Management

Key Topic(s)

- Mandatory FINRA Membership for NYSE Member Organizations
- Member Application Process
- Membership Waive-In Application

Referenced Rules & Notices

- NASD IM-1013-1
- NASD IM-Section 4(b)(1) and (e)
- NASD Rule 1017
- NASD Rule 1021
- NASD Rule 1031
- NASD Rule 8000 Series
- NASD Rule 9000 Series
- NYSE Rule 2

Background & Discussion

As part of the consolidation of NASD and the member regulatory functions of NYSE Regulation, Inc. into FINRA (the Transaction),¹ the SEC approved a rule change to the definition of “member organization” in NYSE Rule 2(b) to require all member organizations that are currently, or propose to become, NYSE member organizations to become members of FINRA.²

In connection with the mandatory membership requirement, FINRA established a waive-in process to expedite the approval of membership applications of the approximately 86 NYSE member organizations that must now become FINRA members. That process is set forth in NASD IM-1013-1, approved by the SEC on October 12, 2007.³ FINRA also established new IM-Section 4(b)(1) and (e) to Schedule A of the By-Laws, which waives the membership application fees for those firms that become FINRA members pursuant to NASD IM-1013-1.

Waive-In Process and Requirements

NASD IM-1013-1 establishes a waive-in process for firms that, as of July 25, 2007: (1) are approved NYSE member organizations, or (2) have submitted an application to become an NYSE member organization and are subsequently approved for NYSE membership (together “NYSE-only member organizations”), provided that such firms were not also NASD members as of July 30, 2007, the closing date of the Transaction. The waive-in process makes these firms automatically eligible to become FINRA members and to register all associated persons whose registrations are approved with NYSE in registration categories recognized by FINRA upon submission to FINRA of a signed waive-in membership application (Waive-In Application) with certain specified information, as set forth below.

The Waive-In Application requires NYSE-only member organizations to submit the following to FINRA:

- ▶ General company information, including Central Registration Depository (CRD®) Number and contact person;
- ▶ An attestation that all information on the applicant’s CRD form, as of the date of submission of the Waive-In Application, is accurate and complete, and fully reflects all aspects of the applicant’s current business, including, but not limited to, ownership structure, management, product lines and disclosures;
- ▶ The identity of the firm’s Executive Representative;⁴
- ▶ Completed and signed Entitlement Forms;
- ▶ A signed FINRA membership agreement; and

- Representations that: (1) the applicant's Form BD will be amended as needed to remain current and accurate, (2) all individual and entity registrations with FINRA will be kept current, and (3) all information and statements contained in the Waive-In Application are current, true and complete.

Once an NYSE-only member organization has completed and submitted a Waive-In Application, FINRA has three business days to review the application, and, if complete, to issue an application approval notification letter. The FINRA membership agreement would become effective on the date of such notification letter.

FINRA has not recognized any new registration categories as a result of the Transaction. Thus, associated persons of the NYSE-only member organizations will be automatically registered with FINRA only for those registration categories that NASD and NYSE jointly recognized at the close of the Transaction (*e.g.*, a General Securities Representative Series 7); provided, however, that the firm must, upon approval of FINRA membership, submit an amended Form U4 for each such associated person, denoting the corresponding FINRA (NASD) registration category (or categories) for such person.

Membership Application Fee Waiver

FINRA also added IM-Section 4(b)(1) and 4(e) to Schedule A of the By-Laws. This provision provides that NYSE member organizations that become members of FINRA pursuant to the waive-in process shall not be assessed the fee set forth in Section 4(b)(1) to Schedule A for the initial Form U4 filed by firms for the registration of any representative or principal associated with the member organization at the time a firm submits its application for FINRA membership. Also, such firms shall not be assessed the membership application fee set forth in Section 4(e) to Schedule A.

Applicable Rules

NYSE-only member organizations admitted pursuant to NASD IM-1013-1 are subject to: NYSE rules incorporated by FINRA; FINRA's By-Laws and Schedules to By-Laws, including Schedule A (Assessments and Fees); and NASD Rule 8000 (Investigations and Sanctions) and Rule 9000 (Code of Procedure) Series, provided that their securities business is limited to Floor brokerage on the NYSE, or routing away to other markets orders that are ancillary to their core Floor business under NYSE Rule 70.40 (permitted Floor activities).⁵

If an NYSE-only member organization admitted pursuant to NASD IM-1013-1 seeks to expand its business operations to include any activities other than the permitted Floor activities, such firm must apply for and receive approval to engage in such business activity pursuant to NASD Rule 1017, which requires an application and prior FINRA approval of material changes in a firm's operations before those changes may occur. Upon approval of such business expansion, the firm would become subject to all FINRA rules.

Additionally, associated persons of an NYSE-only member organization admitted to FINRA pursuant to NASD IM-1013-1 would be subject to the same set of rules as the firm with which they are associated, namely the NYSE rules incorporated by FINRA, FINRA's By-Laws and Schedules to By-Laws, and the NASD Rule 8000 and 9000 Series.

Inasmuch as these associated persons would not be subject to NASD Rules 1021 or 1031, they would not be required to register in a registration category recognized by FINRA. To the extent that such persons continue to be associated solely with a firm whose business complies with the limitations imposed on those firms admitted to FINRA pursuant to the waive-in process, FINRA is not imposing any registration requirements beyond those that the NYSE requires, provided that their business is confined in scope as contemplated in NASD IM-1013-1. The licensing and other requirements applicable to the NYSE-only member organizations and their associated persons, however, are subject to change as part of the process of establishing a consolidated rulebook applicable to all FINRA members.

Endnotes

- 1 On July 26, 2007, the SEC approved amendments to NASD's By-Laws to implement governance and related changes to accommodate the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. *See* Exchange Act Release No. 56145 (July 26, 2007), 72 FR 42169 (August 1, 2007) (File No. SR-NASD-2007-023). The SEC also approved a plan by FINRA and NYSE Regulation to allocate regulatory responsibility relating to the NYSE member firm regulation rules to FINRA. *See* Exchange Act Release No. 56148 (July 26, 2007), 72 FR 42146 (August 1, 2007) (File No. 4-544).
- 2 *See* Exchange Act Release No. 56654 (October 12, 2007), 72 FR 59129 (October 18, 2007) (File No. SR-NYSE-2007-67); *see also* File No. SR-FINRA-2007-019.
- 3 *See* Exchange Act Release No. 56653 (October 12, 2007), 72 FR 59127 (October 18, 2007) (File No. SR-NASD-2007-056).
- 4 As required by Article IV, Section 3 of the FINRA By-Laws.
- 5 *See* Exchange Act Release No. 56653 (October 12, 2007), 72 FR 59127 (October 18, 2007), n. 9. Activities that are ancillary to a Floor broker's core business include: (1) routing orders in NYSE-traded securities to an away market for any reason relating to their ongoing Floor activity, including regulatory compliance or meeting best-execution obligations; or (2) provided that the majority of transactions effected by the firm are effected on the NYSE, sending to other markets orders in NYSE-traded or non-NYSE-traded securities and/or futures if such orders relate to hedging positions in NYSE-traded securities, or are part of arbitrage or program trade strategies that include NYSE-traded securities.

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Attachment A

Below is the text of the rule change. New language is underlined; deletions are in brackets

* * * * *

NYSE Rule 2. “Member,” “Membership,” “Member Firm,” etc.

(a) No Change.

(b)

(i) The term “member organization” means a registered broker or dealer (unless exempt pursuant to the Securities Exchange Act of 1934) that is a member of the Financial Industry Regulatory Authority (“FINRA”) and approved by the Exchange and authorized to designate an associated natural person to effect transactions on the floor of the Exchange or any facility thereof. This term shall include a natural person so registered, approved and licensed and who directly effects transactions on the floor of the Exchange or any facility thereof.

(ii) The term “member organization” also includes [any] a registered broker or dealer that is a member of FINRA, which does not own a trading license and agrees to be regulated by the Exchange as a member organization and which the Exchange has agreed to regulate.

(iii) No Change.

(c) through (h) No Change.

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SCHEDULE A TO NASD BY-LAWS

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Section 1 through Section 4

No Change.

IM-Section 4(b)(1) and (e) — Exemption from Certain Registration and Membership Application Fees for Certain New York Stock Exchange Member Organizations

NYSE member organizations that become members of FINRA pursuant to IM-1013-1 shall not be assessed the fee set forth in Section 4(b)(1) to Schedule A of the NASD By-Laws for the initial Form U-4 filed by firms for the registration of any

representative or principal associated with the member organization at the time a firm submits its application for FINRA membership. Such firms also shall not be assessed the membership application fee set forth in Section 4(e) to Schedule A of the NASD By-Laws. However, those firms will otherwise remain subject to FINRA's By-Laws and Schedules to By-Laws, including Schedule A.

Section 5 through Section 13

No Change.

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1000. MEMBERSHIP, REGISTRATION AND QUALIFICATION REQUIREMENTS

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1013. New Member Application and Interview

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IM-1013-1. Membership Waive-In Process for Certain New York Stock Exchange Member Organizations

This Interpretive Material sets forth a membership waive-in process for certain New York Stock Exchange ("NYSE") member organizations to become members of FINRA as part of the consolidation of the member firm regulatory functions of NASD and NYSE Regulation, Inc. ("NYSE Regulation"). It applies to firms that, as of July 25, 2007, (1) are approved NYSE member organizations or (2) have submitted an application to become an NYSE member organization and are subsequently approved for NYSE membership (together "NYSE-only member organizations"), provided that such firms were not also NASD members as of July 30, 2007. Such firms are eligible to automatically become FINRA members and to automatically register all associated persons whose registrations are approved with NYSE in registration categories recognized by FINRA upon submission to FINRA's Member Regulation Department ("the Department") of a signed waive-in membership application ("Waive-In Application") with the following information:

(1) General company information, including Central Registration Depository (CRD®) Number and contact person.

(2) An attestation that all information on the applicant's CRD form, as of the date of submission of the Waive-In Application is accurate and complete and fully reflects all aspects of the applicant's current business, including, but not limited to, ownership structure, management, product lines and disclosures.

(3) The identity of the firm's Executive Representative.

(4) Completed and signed Entitlement Forms.

(5) A signed FINRA Membership Agreement.

(6) Representations that the NYSE applicant's Uniform Application for Broker-Dealer Registration (Form BD) will be amended as needed to keep current and accurate; that all individual and entity registrations with FINRA will be kept current; and that all information and statements contained in the Waive-In Application are current, true and complete.

The Department shall review the Waive-In Application within three (3) business days of receipt and, if complete, issue a letter notifying the applicant that it has been approved for membership. The Membership Agreement shall become effective on the date of such notification letter.

Firms admitted pursuant to this Interpretive Material shall be subject to the NYSE rules incorporated by FINRA, FINRA's By-Laws and Schedules to By-Laws, including Schedule A, and the NASD Rule 8000 and Rule 9000 Series, provided that their securities business is limited to floor brokerage on the NYSE, or routing away to other markets orders that are ancillary to their core floor business under NYSE Rule 70.40 ("permitted floor activities"). If an NYSE-only member organization admitted pursuant to this Interpretive Material seeks to expand its business operations to include any activities other than the permitted floor activities, such firm must apply for and receive approval to engage in such business activity pursuant to NASD Rule 1017. Upon approval of such business expansion, the firm shall be subject to all NASD rules, in addition to those NYSE rules incorporated by FINRA.

Pursuant to IM-Section 4(b)(1) and (e) to Schedule A of the NASD By-Laws, a firm applying to waive in for membership pursuant to this Interpretive Material shall not be assessed certain registration and application fees set forth in Sections 4(b)(1) and (e) to Schedule A of the NASD By-Laws.

Deferred Variable Annuities

SEC Approves New NASD Rule 2821 Governing Deferred Variable Annuity Transactions

Effective Date: May 5, 2008

Executive Summary

On September 7, 2007, the SEC approved new NASD Rule 2821 regarding broker-dealers' compliance and supervisory responsibilities for deferred variable annuities.¹ The rule text is set forth in Attachment A and is effective May 5, 2008.

Questions regarding this *Notice* may be directed to James S. Wrona, Associate Vice President and Associate General Counsel, Office of General Counsel, at (202) 728-8270; or Lawrence N. Kosciulek, Director, Investment Companies Regulation, at (240) 386-4535.

Discussion

Deferred variable annuities are hybrid investments containing both securities and insurance features.² They offer choices among a number of complex contract options, which can cause confusion for both the individuals who sell them and customers who buy them. FINRA developed Rule 2821 to enhance broker-dealers' compliance and supervisory systems and provide more comprehensive and targeted protection to investors regarding deferred variable annuities.

November 2007

Notice Type

- New Rule

Suggested Routing

- Compliance
- Continuing Education
- Internal Audit
- Legal
- Operations
- Registered Representatives
- Senior Management
- Systems
- Trading
- Training
- Variable Contracts

Key Topics

- Deferred Variable Annuities
- Disclosure
- Principal Review
- Sales Practices
- Suitability
- Supervision
- Training

Referenced Rules & Notices

- NASD Rule 2310
- NASD Rule 2330
- NASD Rule 2820
- NASD Rule 2821
- NASD Rule 3010
- NASD Rule 3012
- NTM 99-35
- NTM 01-23
- NTM 03-71
- NTM 05-50
- NYSE Information Memo 05-54
- SEC Rule 15c3-1
- SEC Rule 15c3-3

The Rule's Application

Rule 2821 applies to the purchase or exchange (not sale or surrender) of a deferred variable annuity and the initial subaccount allocations.³ Rule 2821 does not apply to reallocations of subaccounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. Other FINRA rules, however, are applicable to such transactions. For instance, FINRA's general suitability rule (NASD Rule 2310) continues to apply to any recommendations to reallocate subaccounts or to sell a deferred variable annuity.⁴ Rule 2821 applies to the use of deferred variable annuities to fund IRAs, but not to deferred variable annuities sold to certain tax-qualified, employer-sponsored retirement or benefit plans,⁵ unless a member firm makes a recommendation to an individual plan participant, in which case the rule would apply to that recommendation.⁶

The Rule's Main Requirements

Rule 2821 has four main requirements, which are discussed below. An outline of the general division of responsibility among registered representatives, registered principals and firms is included with this *Notice* (Attachment B). Firms and their associated persons should carefully review the actual rule language, however, to understand the breadth of the obligations that the rule imposes.

Registered Representative Requirements for Recommended Transactions

Under the "Recommendation Requirements" section of the rule,⁷ a registered representative must have a reasonable basis to believe that the customer has been informed, in general terms, of the material features of a deferred variable annuity, such as potential surrender period and surrender charge, potential tax penalty, mortality and expense fees, charges for and features of enhanced riders, insurance and investment components and market risk.⁸ Although the rule requires only generic disclosure, registered representatives and principals may not ignore product-specific features. For example, a firm and its brokers cannot adequately determine the suitability of a transaction without knowing the material features of the deferred variable annuity in question.⁹

This section of the rule also requires that the registered representative have a reasonable basis to believe that the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization or a death or living benefit.¹⁰ The rule does not require that a registered representative determine that the customer would benefit from *all* of these features or that the customer, in hindsight, actually took advantage of one or more of them.

Further, this section states that a registered representative must have a reasonable basis to believe that “the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable....”¹¹ Thus, the suitability determination must include careful consideration of the product in its entirety and its component parts, including initial subaccount allocations.

If an “exchange” of one variable annuity for another is involved, the registered representative must have a reasonable basis to believe that “the transaction as a whole also is suitable for the particular customer” and must consider a number of additional factors.¹² Those factors include “whether (i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits, ... or be subject to increased fees or charges....; (ii) the customer would benefit from product enhancements and improvements; and (iii) the customer’s account has had another deferred variable annuity exchange within the preceding 36 months.”¹³ Regarding the last factor, a registered representative must determine whether the customer has effected another exchange at the broker-dealer at which he or she is performing the review and must make reasonable efforts to ascertain whether the customer has effected an exchange at any other broker-dealer(s) within the preceding 36 months.¹⁴

The rule also requires a registered representative to make reasonable efforts to ascertain and consider various other types of customer-specific information when recommending that a customer purchase or exchange a deferred variable annuity. This information includes the customer’s “age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.”¹⁵ Although not explicitly addressed in the rule, deferred variable annuities generally are considered to be long-term investments and are therefore typically not suitable for investors who have short-term investment horizons.

Finally, a registered representative who recommends the purchase or exchange of a deferred variable annuity must document and sign the determinations discussed above. This signed document must provide reviewing principals with enough information to adequately assess whether the registered representative has complied with the requirements of Rule 2821.

Principal Review and Approval Obligations for All Transactions

The rule's "Principal Review and Approval" section includes both timing and substantive components. With regard to timing, the rule requires review and approval "[p]rior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application...."¹⁶ FINRA recognizes that (in view of the variety of features and provisions of deferred variable annuity contracts) principal review of these investments often can require more time than reviews of many other types of securities transactions. To ensure that broker-dealers have sufficient time for a rigorous and thorough review prior to transmittal, FINRA has provided interpretive relief and the SEC has provided an exemption (as described below) regarding a number of rules that otherwise might have, as a practical matter, shortened the period within which broker-dealers could review the transactions.

Broker-dealers often accept customer checks made payable to the issuing insurance company when customers sign applications for deferred variable annuities. The broker-dealers' receipt of the checks, however, could have triggered application of a number of other rules that might have required relatively quick principal reviews. NASD Rule 2330, for instance, generally prohibits improper use of customer funds, and NASD Rule 2820 specifically requires broker-dealers to "transmit promptly" the application and purchase payment for a variable annuity contract to the issuing insurance company. To alleviate the potential conflict between Rule 2821's review timing requirement and other FINRA rules, FINRA created an important exception: A broker-dealer may hold an application for a deferred variable annuity and a customer's non-negotiated check payable to an insurance company for up to seven business days without violating either Rule 2330 or Rule 2820 if the reason for the hold is to allow completion of principal review of the transaction pursuant to Rule 2821.

An SEC exemption also was needed because "[m]any broker-dealers are subject to lower net capital requirements under [SEC] Rule 15c3-1 and are exempt from the requirement to establish and fund a customer reserve account under [SEC] Rule 15c3-3 because they do not carry customer funds or securities."¹⁷ Although some of these firms receive checks from customers made payable to third parties, the SEC does not deem a firm to be carrying customer funds if it "promptly transmits" the checks to third parties.¹⁸ The SEC has interpreted "promptly transmits" to mean that "such transmission or delivery is made no later than noon of the next business day after receipt of such funds or securities."¹⁹

In conjunction with its approval of Rule 2821, the SEC provided an exemption to the “promptly transmits” requirement under the following conditions:

- The transaction is subject to the principal review requirements of Rule 2821 and a registered principal has reviewed and determined whether he or she approves of the purchase or exchange of the deferred variable annuity within seven business days in accordance with the rule;
- The broker-dealer promptly transmits the check no later than noon of the business day following the date a registered principal reviews and determines whether he or she approves of the purchase or exchange of the deferred variable annuity; and
- The broker-dealer maintains a copy of each such check and creates a record of the date the check was received from the customer and the date the check was transmitted to the insurance company if approved or returned to the customer if rejected.

If all three of these conditions are met, a firm is “exempt from any additional requirements of [SEC] Rules 15c3-1 or 15c3-3 due solely to a failure to promptly transmit a check made payable to an insurance company for the purchase of a deferred variable annuity product by noon of the business day following the date the broker-dealer receives the check from the customer...”²⁰

During the rulemaking process, some commenters asked whether principals must complete or simply begin their review prior to the transmittal of the application to the issuing insurance company. The principal review must be *completed* before transmittal of the application to the insurance company.

A coalition of 32 life insurance companies asked whether the timing of principal review under Rule 2821 would be impacted by a firm’s status as a “captive broker-dealer.” The coalition explained that a number of insurance companies share personnel with affiliated broker-dealers and have centralized units that may share personnel who are responsible for both the broker-dealer’s principal review of the variable annuity application and the insurance company’s issuance process. The coalition sought clarification that receipt of customer applications by broker-dealer personnel for principal review, even if those personnel share office space with and/or also work for the insurer, would not be considered “transmitted to the issuing insurance company for processing” under Rule 2821.

To respond to the coalition’s request for clarification, it is necessary to emphasize that the main purpose of requiring pre-transmittal principal review is to have the principal review and determine whether to approve the application *prior to the issuance of the contract*. Ordinarily, FINRA would consider the application “transmitted” to the insurance company when the broker-dealer sends the application to the insurance company for processing, whether it is sent via electronic means, facsimile transmission,

regular or overnight mail, or courier. The dividing lines can become blurred, however, when a captive broker-dealer and insurance company share office space and/or employees who carry out both the principal review and the issuance process. In such situations, FINRA considers the application “transmitted” to the insurance company only when the broker-dealer’s principal, acting as such, has approved the transaction, provided that the affiliated broker-dealer ensures that arrangements and safeguards exist to prevent the insurance company from issuing the contract prior to principal approval by the broker-dealer.²¹

In addition to addressing the timing of principal review, this section of the rule states that a principal shall treat “all transactions as if they have been recommended for purposes of this principal review” and shall only approve the transaction if he or she determines “that there is a reasonable basis to believe that the transaction would be suitable based on the factors delineated in paragraph (b) of this Rule.”²² A principal who determines that the transaction is unsuitable nonetheless may authorize the processing of the transaction if the principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the principal found it to be unsuitable, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity. All of the determinations required by this part of the rule must be documented and signed by the principal.

FINRA emphasizes, however, that the rule does not *require* broker-dealers to effect trades that they determine are not suitable; rather, the rule *permits* them to do so under the narrow circumstances discussed above. Thus, the rule has no effect on existing principles of law or contractual terms that allow a broker-dealer to decline the acceptance of an order.

A few commenters asked whether principals have a more limited role under the rule if they are employed by a broker-dealer that does not have a sales force and does not make recommendations to customers.²³ The rule requires that a broker-dealer have procedures in place designed to ensure that principals receive appropriate information about both the customer and the product(s) so that they can fulfill their review obligations under the rule and that principals review *all* purchase and exchange orders for suitability, irrespective of whether the orders were recommended.

Firm Supervisory Procedures

The rule specifically requires broker-dealers to establish and maintain written supervisory procedures reasonably designed to achieve compliance with the standards set forth in the rule.²⁴ This part of the rule includes the requirements that the broker-dealer implement surveillance procedures to determine if any “*associated persons* have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable NASD rules, or the federal securities laws (‘inappropriate exchanges’) and have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges....”²⁵ The rule allows a firm to determine how to screen for and supervise such activity. Thus, a firm could perform this type of review on a periodic basis via exception reporting rather than as part of the principal review of each exchange transaction.

Firm Training Program

The fourth main requirement in the rule is a training component,²⁶ which requires that firms create training programs for registered representatives who sell, and for registered principals who review transactions in, deferred variable annuities. Among other factors, firms must include training on the material aspects of deferred variable annuities.

Use of Automated Supervisory Systems

Rule 2821 does not preclude firms from using automated supervisory systems (or a mix of automated and manual supervisory systems) to facilitate compliance with the rule. Of course, firms that intend to rely on automated supervisory systems for compliance with Rule 2821 (or other rules) must remember that, at a minimum, a principal or principals would need to (1) approve the criteria that the automated supervisory system uses; (2) audit and update the automated supervisory system as necessary to ensure compliance with the rule; and (3) review exception reports that the automated supervisory system creates. As is always the case with the exercise of supervision under FINRA rules, the use of any automated supervisory system, aid or tool for the discharge of supervisory duties represents a direct exercise of supervision by the supervisor (a principal or principals under Rule 2821) and the supervisor remains responsible for the discharge of supervisory responsibilities in compliance with the rule. Consequently, a principal or principals relying on such an automated supervisory system is responsible for any deficiency in the system’s criteria that would result in the system not being reasonably designed to comply with Rule 2821.

A broker-dealer need not designate only one principal to perform these tasks. Consistent with NASD Rules 3010 and 3012, a broker-dealer generally is free to allocate supervisory responsibilities among its qualified registered principals as appropriate (whether in the context of automated or manual supervisory reviews). Thus, a broker-dealer may, for example, designate several principals to be responsible for various parts of an automated supervisory system.

Finally, a broker-dealer must ensure that it provides training for (1) the firm's relevant associated persons on how to correctly input information into the automated supervisory system and (2) the firm's principals responsible for reviewing and approving deferred variable annuity transactions on how to use and interpret the reports generated by the firm's automated supervisory systems in order to properly review and monitor deferred variable annuity transactions.²⁷

Endnotes

- 1 See SEC Order Approving FINRA's NASD Rule 2821 Regarding Members' Responsibilities for Deferred Variable Annuities (Approval Order), Securities Exchange Act Release No. 56375 (Sept. 7, 2007), 72 FR 52403 (Sept. 13, 2007) (SR-NASD-2004-183); SEC Corrective Order, Securities Exchange Act Release No. 56375A (Sept. 14, 2007), 72 FR 53612 (Sept. 19, 2007) (SR-NASD-2004-183) (correcting the rule's effective date). Created on July 30, 2007, the Financial Industry Regulatory Authority (FINRA) comprises the former National Association of Securities Dealers, Inc. (NASD) and the member regulation, enforcement and arbitration functions of the New York Stock Exchange (NYSE). The FINRA rulebook consists of both NASD rules and certain NYSE rules until FINRA adopts a consolidated rulebook.
- 2 In general, a variable annuity is a contract between an investor and an insurance company whereby the insurance company promises to make periodic payments to the contract owner or beneficiary, starting immediately (an immediate variable annuity) or at some future time (a deferred variable annuity). See Joint SEC and NASD Staff Report on Broker-Dealer Sales of Variable Insurance Products (June 2004) (Joint Report), available at www.sec.gov/news/studies/secnasdvp.pdf; see also *NASD Notice to Members 99-35* (May 1999); *NYSE Information Memo 05-54* (Aug. 11, 2005).
- 3 Rule 2821(a)(1). The rule covers a stand-alone purchase of a deferred variable annuity and an exchange of one deferred variable annuity for another. For purposes of the rule, an "exchange" of a product other than a deferred variable annuity (such as a fixed annuity) for a deferred variable annuity would be covered by the rule as a "purchase." The rule does not cover customer sales or surrenders of deferred variable annuities, including the sale or surrender of a deferred variable annuity in connection with an "exchange" of a deferred variable annuity for another product (such as a fixed annuity).
- 4 In a 2002 *Regulatory & Compliance Alert* entitled "Reminder—Suitability of Variable Annuity Sales," FINRA emphasized that Rule 2310 "applies to any recommendation to sell a variable annuity regardless of the use of the proceeds, including situations where the member recommends using the proceeds to purchase an unregistered product such as an equity-indexed annuity. Any recommendation to sell the variable annuity must be based upon the financial situation, objectives and needs of the particular investor." *Regulatory & Compliance Alert* (Spring 2002) at 13. See also *NASD Notice to Members 05-50* (Aug. 2005) ("[R]ecommendations to ... surrender a ... variable annuity ... must be suitable, including where such ... surrender[s] are for the purpose of funding the purchase of an unregistered EIA."). As part of the suitability analysis under Rule 2310 regarding a recommendation to sell a deferred variable annuity, a registered representative must consider, *inter alia*, tax consequences, surrender charges and loss of benefits (such as death, living or other contractual benefits).
- 5 A deferred variable annuity purchased to fund an IRA (or other tax deferred account or vehicle) does not provide any additional tax deferred treatment of earnings beyond the treatment provided by the IRA (or other tax deferred account or vehicle) itself. Accordingly, where a customer is purchasing a deferred

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Endnotes (cont'd)

- variable annuity to fund an IRA (or other tax deferred account or vehicle), firms must ensure that features other than tax deferral make the purchase of the deferred variable annuity for the IRA (or other tax deferred account or vehicle) appropriate.
- 6 Another issue that arose during the rulemaking process is whether Rule 2821 would apply if a registered representative recommended a deferred variable annuity to an individual retirement plan participant and the annuity was the only funding vehicle for the employer's retirement plan. If the registered representative "recommends" the deferred variable annuity, then Rule 2821 would apply. However, not all communications about a deferred variable annuity would constitute a "recommendation" that triggers application of the rule. For instance, a firm's generic communication to plan participants indicating only that their employer has chosen a deferred variable annuity as the funding vehicle for its retirement plan generally would not constitute a "recommendation" triggering application of the rule. For a review of guidelines for determining whether a particular communication could be deemed a "recommendation," see *NASD Notice to Members 01-23* (Apr. 2001).
 - 7 Rule 2821(b).
 - 8 Rule 2821(b)(1)(A)(i). While the rule does not specify the exact type or form of disclosure that is required, a registered representative who merely delivers a prospectus to an investor ordinarily would not have a reasonable basis to believe that the customer has been instructed or educated—"informed"—about the material features of a deferred variable annuity for purposes of the rule.
 - 9 A broker's understanding of the features of an investment product is an important component of both reasonable-basis suitability (*i.e.*, the requirement that a broker determine, after appropriate due diligence, whether the product is suitable for at least *some* investors) and customer-specific suitability (*i.e.*, the requirement that the broker determine whether the product is suitable for the particular customer at issue). See *NASD Notice to Members 03-71* (Nov. 2003).
 - 10 In the past, it was apparent that some brokers and investors did not fully understand important aspects of these features. For instance, "although a benefit of a variable annuity investment is that earnings accrue on a tax-deferred basis, a minimum holding period is often necessary before the tax benefits are likely to outweigh the often higher fees imposed on variable annuities relative to alternative investments, such as mutual funds." *NASD Notice to Members 99-35* (May 1999). See also *NYSE Information Memo 05-54* (Aug. 11, 2005) ("A customer of advanced years might lack the actuarial expectations necessary for a deferred variable annuity to yield its benefit of income shelter versus costs, and his or her lower tax bracket might render such benefits marginal or negative.").
 - 11 Rule 2821(b)(1)(A)(iii).
 - 12 *Id.*
 - 13 Rule 2821(b)(1)(B).
 - 14 FINRA generally would view asking customers whether they had an exchange at another broker-dealer within 36 months to be a "reasonable effort" in this context.
 - 15 Rule 2821(b)(2).

Endnotes (cont'd)

- 16 Rule 2821(c).
- 17 SEC Order Granting Exemption to Broker-Dealers from Requirements in Rules 15c3-1 and 15c3-3 to Promptly Transmit Customer Checks (Exemption Order), Securities Exchange Act Release No. 56376 (Sept. 7, 2007), 72 FR 52400 (Sept. 13, 2007).
- 18 See Securities Exchange Act Release No. 31511 (Nov. 24, 1992) (stating that a firm shall not be deemed to receive funds if checks are payable to an entity other than itself—such as to another broker-dealer or escrow agent—and the firm promptly forwards such funds to the third party).
- 19 *Id.*, note 11, and 17 CFR §240.15c3-1(c)(9). The SEC has extended this definition to SEC Rule 15c3-3(k). See NYSE's SEC Rule Interpretations Handbook, at 15c3-3(k)(2)(ii)/015.
- 20 Exemption Order, *supra* note 17.
- 21 Several commenters have asked, in the case where a captive broker-dealer shares office space and/or employees with the insurance company, whether, in advance of the broker-dealer's principal approval of the transaction, the customer's funds could be deposited in an account at the insurance company and administration of the issuance processing could begin. The rule does not permit depositing the customer's funds in an account at the insurance company prior to completion of principal review. The rule, however, does not prohibit using the information required for principal review and approval in aid of the issuance process. For instance, the rule generally does not prohibit a broker-dealer from inputting information used as part of its suitability review into a shared database (irrespective of the media used for that database, *i.e.*, paper or electronic) that the insurer uses for the issuance process, provided that no further steps are taken in the issuance process.
- 22 Rule 2821(c).
- 23 One commenter asked whether Rule 2821 applies to an issuer's direct sale of a deferred variable annuity to a customer without any involvement of a broker-dealer or persons associated with a broker-dealer. FINRA's rules apply only to member broker-dealers and their associated persons. FINRA notes, however, that the determination of whether an entity should be registered as a broker-dealer rests with the SEC.
- 24 See Rule 2821(d).
- 25 *Id.* (emphasis added). FINRA notes that Rule 2821(d)(1) focuses on whether an *associated person* has effected an inappropriate number of exchanges, while Rule 2821(b)(1)(B)(iii) focuses on whether a particular *customer* has had another exchange within a 36-month period.
- 26 See Rule 2821(e).
- 27 The firm also would need to comply with applicable requirements of NASD Rule 3110 and SEC Rules 17a-3 and 17a-4 and interpretations thereof.

ATTACHMENT A

New language is underlined.

* * * * *

2821. Members' Responsibilities Regarding Deferred Variable Annuities

(a) General Considerations

(1) Application

This Rule applies to the purchase or exchange of a deferred variable annuity and the subaccount allocations. This Rule does not apply to reallocations of subaccounts made or to funds paid after the initial purchase or exchange of a deferred variable annuity. This Rule also does not apply to deferred variable annuity transactions made in connection with any tax-qualified, employer-sponsored retirement or benefit plan that either is defined as a "qualified plan" under Section 3(a)(12)(C) of the Securities Exchange Act of 1934 or meets the requirements of Internal Revenue Code Sections 403(b), 457(b), or 457(f), unless, in the case of any such plan, a member or person associated with a member makes recommendations to an individual plan participant regarding a deferred variable annuity, in which case the Rule would apply as to the individual plan participant to whom the member or person associated with the member makes such recommendations.

(2) Creation, Storage, and Transmission of Documents

For purposes of this Rule, documents may be created, stored, and transmitted in electronic or paper form, and signatures may be evidenced in electronic or other written form.

(3) Definitions

For purposes of this Rule, the term "registered principal" shall mean a person registered as a General Securities Sales Supervisor (Series 9/10), a General Securities Principal (Series 24), or an Investment Company Products/Variable Contracts Principal (Series 26), as applicable.

(b) Recommendation Requirements

(1) No member or person associated with a member shall recommend to any customer the purchase or exchange of a deferred variable annuity unless such member or person associated with a member has a reasonable basis to believe

(A) that the transaction is suitable in accordance with Rule 2310 and, in particular, that there is a reasonable basis to believe that

(i) the customer has been informed, in general terms, of various features of deferred variable annuities, such as the potential surrender period and surrender charge; potential tax penalty if customers sell or redeem deferred variable annuities before reaching the age of 59½; mortality and expense fees; investment advisory fees; potential charges for and features of riders; the insurance and investment components of deferred variable annuities; and market risk;

(ii) the customer would benefit from certain features of deferred variable annuities, such as tax-deferred growth, annuitization, or a death or living benefit; and

(iii) the particular deferred variable annuity as a whole, the underlying subaccounts to which funds are allocated at the time of the purchase or exchange of the deferred variable annuity, and riders and similar product enhancements, if any, are suitable (and, in the case of an exchange, the transaction as a whole also is suitable) for the particular customer based on the information required by subparagraph (b)(2) of this Rule; and

(B) in the case of an exchange of a deferred variable annuity, the exchange also is consistent with the suitability determination required by subparagraph (b)(1)(A) of this Rule, taking into consideration whether

(i) the customer would incur a surrender charge, be subject to the commencement of a new surrender period, lose existing benefits (such as death, living, or other contractual benefits), or be subject to increased fees or charges (such as mortality and expense fees, investment advisory fees, or charges for riders and similar product enhancements);

(ii) the customer would benefit from product enhancements and improvements; and

(iii) the customer's account has had another deferred variable annuity exchange within the preceding 36 months.

The determinations required by this paragraph shall be documented and signed by the associated person recommending the transaction.

(2) Prior to recommending the purchase or exchange of a deferred variable annuity, a member or person associated with a member shall make reasonable efforts to obtain, at a minimum, information concerning the customer's age, annual income, financial situation and needs, investment experience, investment objectives, intended use of the deferred variable annuity, investment time horizon, existing assets (including investment and life insurance holdings), liquidity needs, liquid net worth, risk tolerance, tax status, and such other information used or considered to be reasonable by the member or person associated with the member in making recommendations to customers.

(c) Principal Review and Approval

Prior to transmitting a customer's application for a deferred variable annuity to the issuing insurance company for processing, but no later than seven business days after the customer signs the application, a registered principal shall review and determine whether he or she approves of the purchase or exchange of the deferred variable annuity. Subject to the exception in this paragraph, and treating all transactions as if they have been recommended for purposes of this principal review, a registered principal shall approve the transaction only if the registered principal has determined that there is a reasonable basis to believe that the transaction would be suitable based on the factors delineated in paragraph (b) of this Rule. Notwithstanding the foregoing, a registered principal may authorize the processing of the transaction if the registered principal determines that the transaction was not recommended and that the customer, after being informed of the reason why the registered principal has not approved the transaction, affirms that he or she wants to proceed with the purchase or exchange of the deferred variable annuity. The determinations required by this paragraph shall be documented and signed by the registered principal who reviewed and approved, rejected, or authorized the transaction.

(d) Supervisory Procedures

In addition to the general supervisory and recordkeeping requirements of Rules 3010, 3012, 3013, and 3110, a member must establish and maintain specific written supervisory procedures reasonably designed to achieve compliance with the standards set forth in this Rule. The member also must (1) implement surveillance procedures to determine if any of the member's associated persons have rates of effecting deferred variable annuity exchanges that raise for review whether such rates of exchanges evidence conduct inconsistent with the applicable provisions of this Rule, other applicable NASD rules, or the federal securities laws ("inappropriate exchanges") and (2) have policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.

(e) Training

Members shall develop and document specific training policies or programs reasonably designed to ensure that associated persons who effect and registered principals who review transactions in deferred variable annuities comply with the requirements of this Rule and that they understand the material features of deferred variable annuities, including those described in subparagraph (b)(1)(A)(i) of this Rule.

* * * * *

ATTACHMENT B

Division of Responsibilities Outline under Rule 2821 (Deferred Variable Annuities)

This outline highlights the general division of responsibility among registered representatives, registered principals and firms under Rule 2821. Please be aware that, in the case of any misunderstanding, the rule language prevails. In addition, please note that your firm may have additional policies and procedures that registered representatives and principals must follow.

Registered Representatives (RRs),

► **when recommending either a purchase or an exchange of a deferred variable annuity, must**

1. reasonably try to obtain and consider information about the customer, including
 - a. age
 - b. annual income
 - c. financial situation and needs
 - d. investment experience
 - e. investment objectives
 - f. intended use of the deferred variable annuity
 - g. investment time horizon
 - h. existing assets (e.g., investment and life insurance holdings)
 - i. liquidity needs
 - j. liquid net worth
 - k. risk tolerance
 - l. tax status
2. reasonably believe that the purchase or exchange is suitable, based on a variety of factors, including
 - a. the customer has been informed, in general terms, of the material features of deferred variable annuities, such as

<ul style="list-style-type: none"> • potential surrender period and surrender charge • potential tax penalty components • mortality and expense fees 	<ul style="list-style-type: none"> • charges for and features of enhanced riders, if any • insurance and investment • market risk
---	--
 - b. the customer would benefit from one or more features of deferred variable annuities, such as

<ul style="list-style-type: none"> • tax-deferred growth • annuitization 	<ul style="list-style-type: none"> • a death or living benefit
--	---
 - c. the particular deferred variable annuity as a whole, underlying subaccounts, and riders and similar product enhancements, if any, are suitable
3. document and sign his or her determinations, providing the principal assigned to review the transaction with enough information to assess compliance with the rule

► **when determining suitability for a recommended exchange of a deferred variable annuity, also must consider whether the customer**

1. would incur a surrender charge, be subject to a new surrender period, lose existing benefits or be subject to increased fees or charges
2. would benefit from product enhancements and improvements
3. has exchanged a deferred variable annuity within the last 36 months

Registered Principals

1. must review each purchase and exchange and determine whether to approve the transaction before sending the customer's application to the insurer for processing, but no later than seven business days after the customer has signed the application
2. must treat all transactions as if they have been recommended for purposes of review
3. can approve the transaction only if he or she reasonably believes that it is suitable based on the factors that RRs must consider for recommended transactions
4. may authorize the processing of an unsuitable transaction if the principal determines both that
 - a. the transaction was not recommended and
 - b. the customer, after being told why the principal found it to be unsuitable, has stated that he or she wants to proceed with the purchase or exchange
5. must document and sign all determinations

Broker-Dealer Firms,

➤ with respect to supervisory procedures, must

1. have written supervisory procedures reasonably designed to achieve compliance with the rule
2. have surveillance procedures to identify which, if any, of their RRs have a rate of effecting exchanges that raises a question as to whether those exchanges comply with this or other rules
3. have procedures to address and correct exchanges that do not comply with this or other rules

➤ with respect to training, must

1. create training programs on deferred variable annuities for RRs who sell, and for principals who review transactions in, these products

Fairness Opinions

SEC Approves New NASD Rule 2290 Regarding Fairness Opinions

Effective Date: December 8, 2007

Executive Summary

Effective December 8, 2007, new NASD Rule 2290 (Fairness Opinions) requires specific disclosures and procedures addressing conflicts of interest when member firms provide fairness opinions in change of control transactions, such as a merger or sale or purchase of assets.¹ NASD Rule 2290, as adopted, is set forth in Attachment A of this *Notice*.

Questions regarding this *Notice* may be directed to:

- ▶ Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104;
- ▶ Kathryn M. Moore, Assistant General Counsel, OGC, at (202) 974-2974; or
- ▶ Joseph E. Price, Vice President, Corporate Financing Department, at (240) 386-4623.

November 2007

Notice Type

- ▶ New Rule

Suggested Routing

- ▶ Compliance
- ▶ Corporate Finance
- ▶ Legal
- ▶ Senior Management

Key Topic(s)

- ▶ Fairness Opinions
- ▶ Mergers and Acquisitions

Referenced Rules & Notices

- ▶ NASD Rule 2290

Background and Discussion

A fairness opinion addresses, from a financial point of view, the fairness of the consideration in a transaction. Fairness opinions are routinely used by directors of companies in connection with a change of control transaction, such as a merger or sale or purchase of assets, to satisfy their fiduciary duties to act with due care and in an informed manner.

Although not required by statute or regulation, fairness opinions have become commonplace in change of control transactions following the 1985 Delaware Supreme Court case of *Smith v. Van Gorkom*,² in which a corporate board was held to have breached its fiduciary duty of care by approving a merger without adequate information on the transaction, including information on the value of the company and the fairness of the offering price.

In addition to providing a basis for the exercise of care by the board of directors, a fairness opinion, or information about a fairness opinion, is often provided to shareholders as a part of the proxy materials relating to a change of control transaction. Fairness opinions express a conclusion as to the whether the consideration offered in a transaction is within the range of what would be considered “fair”; such opinions generally do not offer an opinion as to whether the consideration offered is the best price that could likely be attained or reach other matters, such as solvency issues, that may arise from the transaction.

Under the SEC’s proxy rules, which apply to issuers, certain disclosures about potential conflicts of interest are provided to investor-shareholders. NASD Rule 2290 is a complementary rule that requires broker-dealers that render fairness opinions to inform investor-shareholders about the potential conflicts of interest that may exist between the firm rendering the fairness opinion and the issuer. The Rule also addresses specific procedures concerning the issuance of fairness opinions.

Disclosures Required by NASD Rule 2290(a)

The Rule sets forth the parameters when the disclosures are required to be contained in a fairness opinion. If a member firm knows or has reason to know, at the time a fairness opinion is issued to a company’s board, that the opinion will be provided or described to the company’s public shareholders, the firm must make the enumerated disclosures in the fairness opinion. A firm will be deemed to have a reason to know that the fairness opinion will be provided or described to public shareholders, if, for example, the structure of the transaction will require a shareholder vote. The fairness opinions covered by the Rule include those issued to the board of directors, and/or any special committee or other subset or committee of the board.

Acting as Financial Advisor and Contingent Compensation

A member firm is required to disclose if the firm has acted as a financial advisor to any party to the transaction that is the subject of the fairness opinion, and, if applicable, that it will receive compensation that is contingent upon the successful completion of the transaction, for rendering the fairness opinion and/or serving as an advisor. This requirement includes significant payments or compensation from related transactions (e.g., stapled financings) if such transactions are contingent upon the completion of the transaction for which the fairness opinion was issued. This disclosure, along with the disclosures in paragraphs (a)(2) and (a)(3), requires descriptive information rather than quantitative information. In addition, FINRA notes that none of the Rule's disclosure provisions requires a member to breach any of its confidentiality obligations.

Other Significant Payment or Compensation

A member firm must disclose if it will receive any other significant payment or compensation contingent upon the successful completion of the transaction. FINRA has chosen not to establish a particular dollar or percentage figure as to what may be considered "significant" out of a concern that establishing a specific figure may become a de facto standard for such payments. Given that the nature of the provision is to inform investors of conflicts of interest, and that paragraph (a)(2) is to prevent circumvention of the provisions in paragraph (a)(1), the receipt of *de minimis* fees (such as trading fees or other small incremental fees from account assets or activity) would not be required to be disclosed. FINRA believes that a "significant" payment or contingent compensation is one that a reasonable person, who reads a fairness opinion, would have an interest in knowing about in order to assess whether the member firm authoring the fairness opinion has a potential conflict of interest.

Material Relationships

A member firm is required to disclose any material relationships that existed during the past two years or that are mutually understood to be contemplated in which any compensation was received or is intended to be received as a result of the relationship between the firm and any party to the transaction that is the subject of the fairness opinion. FINRA notes that this disclosure requirement attaches to material relationships between the member firm and all parties to the transaction, not just the party whose board of directors selected the member firm to render the fairness opinion; e.g., in the case of a takeover, a member issuing a fairness opinion to the target's board of directors would also have to disclose any material relationships it had with the acquirer. As noted above, the disclosure is not required to be quantified, but each of the material relationships should be identified in the fairness opinion.

Independent Verification of Information

A member firm is required to disclose if any information that formed a substantial basis for the fairness opinion that was supplied to the firm by the company requesting the opinion concerning the companies that are parties to the transaction has been independently verified by the firm, and if so, a description of the information or categories of information that were verified. When no information has been verified, a blanket statement to that effect is sufficient. On the other hand, if a member firm independently verifies some or all of the information supplied to it concerning the companies that are parties to the transaction, it must describe the information or the categories of information that were verified. In those instances, FINRA notes that a firm making such a representation may also wish to explain in the fairness opinion its process or standards for independent verification.

Use of Fairness Committee

A disclosure of whether or not the fairness opinion was approved or issued by a fairness committee is required. For purposes of the Rule, the term, "fairness committee" includes any committee or group that approves a fairness opinion in accordance with the requirements of paragraph (b) regardless of whether the member firm calls it a "fairness committee."

Compensation to Insiders

Finally, member firms are required to disclose whether or not the fairness opinion expresses an opinion about the fairness of the amount or nature of the compensation to any of the company's officers, directors or employees, or class of such persons, relative to the compensation to the public shareholders of the company. This disclosure highlights to the investor the potential conflict of interest between the member issuing the fairness opinion and the issuer receiving the opinion by requiring disclosure of whether the member did or did not take into account the amount and nature of compensation flowing to certain insiders relative to the benefits to shareholders in reaching a fairness determination.

Procedures Required by NASD Rule 2290(b)

NASD Rule 2290(b) requires that any member firm issuing a fairness opinion must have written procedures for approval of a fairness opinion. The firm must have procedures regarding the types of transactions and the circumstances in which the firm will use a fairness committee to approve or issue a fairness opinion, and in those transactions in which it uses a fairness committee:

- (A) the process for selecting personnel to be on the fairness committee;
- (B) the necessary qualifications of persons serving on the fairness committee; and
- (C) the process to promote a balanced review by the fairness committee, which shall include the review and approval by persons who do not serve on the deal team to the transaction.

FINRA notes that paragraph (b)(1)(C) does not require that the fairness committee be comprised entirely of persons not serving on or advising the deal team. Rather, the provision requires that the firm have procedures to promote a balanced review by including on the fairness committee persons who are not serving on the deal team. Whether a person is considered to be part of the deal team requires an analysis of the particular facts and circumstances, and will not necessarily be determined by whether a person is included on all document distributions or participated in certain meetings. The determination of whether a person is part of a deal team will depend on the nature and substance of his or her contacts and the advice rendered to the firm.

Firms are also required to have a process to determine whether the valuation analyses used in the fairness opinion are appropriate.

The new rule becomes effective on December 8, 2007. An outline of the disclosure and procedural requirements under the Rule is included in Attachment B.

Endnotes

- 1 See Securities Exchange Act Release No. 56645 (October 11, 2007), 72 FR 59317 (October 19, 2007) (Approval Order of SR-NASD-2005-080).
- 2 488 A.2d 858 (Del. 1985).

ATTACHMENT A

New language is underlined, deletions are in brackets.

* * * * *

2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC

* * * * *

2290. Fairness Opinions

(a) Disclosures

If at the time a fairness opinion is issued to the board of directors of a company the member issuing the fairness opinion knows or has reason to know that the fairness opinion will be provided or described to the company's public shareholders, the member must disclose in the fairness opinion:

(1) if the member has acted as a financial advisor to any party to the transaction that is the subject of the fairness opinion, and, if applicable, that it will receive compensation that is contingent upon the successful completion of the transaction, for rendering the fairness opinion and/or serving as an advisor;

(2) if the member will receive any other significant payment or compensation contingent upon the successful completion of the transaction;

(3) any material relationships that existed during the past two years or that are mutually understood to be contemplated in which any compensation was received or is intended to be received as a result of the relationship between the member and any party to the transaction that is the subject of the fairness opinion;

(4) if any information that formed a substantial basis for the fairness opinion that was supplied to the member by the company requesting the opinion concerning the companies that are parties to the transaction has been independently verified by the member, and if so, a description of the information or categories of information that were verified;

(5) whether or not the fairness opinion was approved or issued by a fairness committee; and

(6) whether or not the fairness opinion expresses an opinion about the fairness of the amount or nature of the compensation to any of the company's officers, directors or employees, or class of such persons, relative to the compensation to the public shareholders of the company.

(b) Procedures

Any member issuing a fairness opinion must have written procedures for approval of a fairness opinion by the member, including:

(1) the types of transactions and the circumstances in which the member will use a fairness committee to approve or issue a fairness opinion, and in those transactions in which it uses a fairness committee:

(A) the process for selecting personnel to be on the fairness committee;

(B) the necessary qualifications of persons serving on the fairness committee;

(C) the process to promote a balanced review by the fairness committee, which shall include the review and approval by persons who do not serve on the deal team to the transaction; and

(2) the process to determine whether the valuation analyses used in the fairness opinion are appropriate.

* * * * *

ATTACHMENT B

Outline of Fairness Opinion Rule Requirements

This outline highlights the disclosure and procedural requirements under NASD Rule 2290. Please be aware that, in the case of any misunderstanding, the rule language prevails. In addition, please note that your firm may have additional policies and procedures that must be followed.

Disclosures

A broker-dealer issuing a fairness opinion that will be disclosed to a company's public shareholders must make the following disclosures in the fairness opinion:

- ▶ If the broker-dealer will receive any compensation contingent on the successful completion of the transaction for acting as a financial adviser to any party to the transaction or otherwise;
- ▶ Any contemplated or existing material relationships involving the payment or receipt of compensation between the broker-dealer and any party to the transaction during the last two years;
- ▶ If the firm has independently verified any information supplied by the company requesting the fairness opinion, which is a substantial basis for the opinion and, if so, describe the information;
- ▶ Whether the fairness opinion was approved or issued by a fairness committee; and
- ▶ Whether the fairness opinion expresses an opinion about the fairness of the compensation to any of the company's insiders, relative to the compensation to the company's public shareholders.

Procedures

Any broker-dealer issuing a fairness opinion must have written procedures for approval of a fairness opinion including:

- ▶ When a member will use a fairness committee and where a fairness committee is used, the firm must specify:
 - ▶ the process for selecting members of the fairness committee;
 - ▶ the necessary qualifications for committee members; and
 - ▶ the process to promote a balanced review by the fairness committee, which includes the review and approval of persons who are not on the transaction deal team.
- ▶ The firm must specify the process to determine that valuation analyses used are appropriate.

Personnel Background Investigations

FINRA Reminds Member Firms of Their Obligations Regarding Background Investigations of Prospective Personnel

Executive Summary

A critical part of the hiring process in the securities industry is the background investigation of prospective personnel. For instance, background investigations can help member firms determine whether a prospective employee is subject to a statutory disqualification or whether he or she may present a regulatory risk for the firm and customers. It is essential for firms to understand their obligations with respect to background investigations. As such, this *Notice* reminds member firms of their obligations under FINRA rules.

Questions concerning this *Notice* may be directed to the Office of General Counsel at (202) 728-8071.

Background and Discussion

Separate, mutually exclusive provisions of the FINRA rules govern member firms' obligations regarding background investigations of prospective personnel, as described below.

NASD Rule 3010(e)

NASD Rule 3010(e) provides that a member firm must ascertain by investigation the good character, business reputation, qualifications and experience of a job applicant before the firm applies to register that applicant with FINRA. NASD Rule 3010(e) requires an extensive, thorough and diligent investigation of a potential applicant's background.

November 2007

Notice Type

- Guidance

Suggested Routing

- Compliance
- Executive Representatives
- Human Resources
- Legal
- Operations
- Principals
- Registered Representatives
- Registration
- Senior Management
- Training

Key Topic(s)

- Background Investigations
- Central Registration Depository (CRD®)
- Fingerprints
- Forms U4 and U5
- Hiring Process
- Statutory Disqualification

Referenced Rules & Notices

- Article III, Sections 3 and 4 of the FINRA By-Laws
- NASD Rule 3010(e)
- NTM 97-19
- NTM 05-39
- NYSE Interpretation Handbook Rule 345.11/01
- NYSE Rule 345.11
- NYSE Rule 346

Undertaking such a background investigation can help the firm detect potential issues when considering persons for employment. NASD Rule 3010(e) does not place any limits on the scope of such a background investigation. The firm must obtain all of the information necessary to determine the applicant's character, business reputation, qualifications and experience.¹

In addition, if the job applicant previously has been registered with FINRA, NASD Rule 3010(e) requires that the firm review a copy of the applicant's most recent Form U5 (Uniform Termination Notice for Securities Industry Registration) within 60 days of the filing date of an application for registration, or demonstrate that it has made reasonable efforts to do so.²

Dual member firms of FINRA and the NYSE also are subject to NYSE Rule 345.11, which is incorporated into the FINRA rules.³

Statutory Disqualification Provisions

Article III, Section 3 of the FINRA By-Laws provides, among other things, that no person may become associated with a member firm, continue to be associated with a member firm or transfer association to another member firm if such person is or becomes subject to a disqualification under Article III, Section 4 of the FINRA By-Laws.⁴ Among other events, certain criminal convictions cause an individual to be subject to a disqualification.⁵ Firms have an obligation to determine whether prospective personnel, including persons who are not required to be registered, are subject to a disqualification under Article III, Section 4.

Form U4 Requirements

As set forth in the Form U4, the person signing the Form U4 on behalf of the member firm must certify that he or she has taken appropriate steps to verify the accuracy and completeness of the information contained in and with the Form U4. This requires thorough review of the Form U4 and appropriate steps to verify all of the information contained in and with the Form U4, such as the applicant's 10-year employment history.

In addition, the Form U4 provides that the person signing the Form U4 on behalf of the firm must certify that the firm has communicated with all of the applicant's previous employers for the past three years and has documentation on file with the names of the persons contacted and the date of contact. Firms should be aware that complying with this Form U4 requirement does not, in and of itself, satisfy any of the other obligations regarding background investigations of prospective personnel discussed in this *Notice*.

Resources

To satisfy the obligations discussed in this *Notice*, firms should consider all available information gathered in the hiring process, including, but not limited to Forms U4 and U5 responses, authorized searches of the CRD, fingerprint results⁶ and communications with previous employers. Firms must ensure that they obtain and retain the required written consent of the applicant in connection with CRD pre-registration searches. Firms also may wish to consider private background checks, credit reports and reference letters.⁷

Firms must ensure that personnel background investigations are conducted in accordance with all applicable laws, rules and regulations (including federal and state requirements) and that all necessary approvals, consents and authorizations have been obtained.

Endnotes

- 1 Member firms must comply with Municipal Securities Rulemaking Board (MSRB) Rule G-7 regarding those applicants engaged solely in municipal securities activities.
 - 2 Firms also must review a job applicant's employment experience to determine if the applicant has been recently employed by a Futures Commission Merchant or an Introducing Broker that is notice-registered with the SEC pursuant to Section 15(b)(11) of the Securities Exchange Act of 1934 (Exchange Act). In such a case, the hiring member also is required to review a copy of the applicant's most recent Commodity Futures Trading Commission Form 8-T.
 - 3 NYSE Rule 345.11 requires member organizations to investigate thoroughly the previous record of: (1) persons required to be registered with the NYSE; (2) persons who regularly handle or process securities or monies or maintain the books and records relating to securities or monies who are not otherwise required to be registered; and (3) persons having direct supervisory responsibility over persons engaged in the above activities who are not otherwise required to be registered.
- For persons required to be registered with the NYSE, member organizations fulfill their investigative obligation by verifying the information contained in the Form U4 (Uniform Application for Securities Industry Registration or Transfer) and by reviewing the applicant's most recent Form U5, if the applicant previously has been registered. For persons subject to NYSE Rule 345.11 who are not required to be registered, member organizations fulfill their investigative obligation by verifying the information contained in the employment questionnaire or application required under SEC Rule 17a-3(a)(12). NYSE Rule 345.11 also requires member organizations to make further inquiry, where appropriate, in light of the background information developed, the position for which the person is being considered or other circumstances. *See also* NYSE Interpretation Handbook Rule 345.11/01.

Endnotes (cont'd)

- 4 Dual member firms of FINRA and the NYSE also are subject to the disqualification provisions of NYSE Rule 346.
- 5 See Sections 3(a)(39) and 15(b)(4) of the Exchange Act.
- 6 Pursuant to Section 17(f)(2) of the Exchange Act and SEC Rule 17f-2, certain persons employed in the securities industry are required to be fingerprinted for purposes of a criminal background check. Firms are responsible for obtaining a prospective employee's fingerprints and certain required identifying information. Firms then submit the prospective employee's fingerprints together with the required identifying information to FINRA. FINRA, in turn, submits these fingerprints to the FBI. FINRA also makes the fingerprint results available to the employing member firm and regulators, consistent with applicable federal laws and FBI and FINRA requirements. See *NASD Notice to Members 05-39 (NASD Suggests Best Practices for Fingerprinting Procedures)* (May 2005).
- 7 To identify registered persons with a history of customer complaints, disciplinary actions or arbitrations, firms also should consider the following "best hiring practices" set forth in *NASD Notice to Members 97-19* (April 1997): (1) discuss with the applicant the nature of the applicant's prior customers and the types of securities sold while associated with prior employers; (2) obtain from the applicant explanations regarding any customer complaints and regulatory actions to determine the merit, to the extent practicable, of each before hiring; (3) ask applicants about the existence of and nature of any pending proceedings, customer complaints, regulatory investigations or arbitrations not listed in CRD; and (4) involve compliance and legal staff, as appropriate, in the hiring process, and designate an individual (above the branch manager level) or a committee to review the customer complaints, disciplinary actions or arbitrations before hiring a registered person with such a history.

©2007. FINRA. All rights reserved. *Regulatory Notices* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

PLEASE NOTE: On July 30, 2007, the Financial Industry Regulatory Authority, FINRA, began operations. FINRA was formed through the consolidation of NASD and the enforcement, member regulation and arbitration operations of NYSE Regulation. The FINRA rulebook currently consists of both NASD Rules and certain NYSE Rules that FINRA has incorporated (Incorporated NYSE Rules). The Incorporated NYSE Rules apply solely to dual members of FINRA and the NYSE. In certain instances, the Firm Element Advisory continues to use legacy references to NASD and NYSE member regulation.

Continuing Education

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

Executive Summary

This *Notice* advises firms of the fourth quarter 2007 Securities Industry/Regulatory Council on Continuing Education Firm Element Advisory, which identifies regulatory and sales practice topics that firms should consider in their Firm Element training plans. Topics updated or added since the prior Advisory are indicated in the document as such.

The updated Firm Element Advisory is available at www.cecouncil.com/publications/council_publications/FEA_2007_Semi_Annual_Update.pdf.

Questions concerning this *Notice* may be directed to Joseph Sheirer, Director, Continuing Education, at (212) 656-5917; or Roni Meikle, Director, Continuing Education, at (212) 656-2156.

November 2007

Notice Type

- Guidance

Suggested Routing

- Compliance
- Continuing Education
- Legal
- Registration
- Senior Management

Key Topic(s)

- Continuing Education
- Firm Element

Background and Discussion

The Securities Industry/Regulatory Council on Continuing Education Firm Element Advisory is published during the second and fourth quarters of each year, and identifies regulatory and sales practice topics that firms should consider including in their Firm Element training plans. The topics are based on a review of industry and self-regulatory organizations' publications and other communications.

The Advisory topics are not exhaustive and are intended as a guide to firms when they determine what to include in their training plans. Firms should consider the specific nature of their business, clients, products and services when creating their training plans.

The updated FEA is available on the Council's Web site at www.cecouncil.com/publications/council_publications/FEA_2007_Semi_Annual_Update.pdf.

Representation of Parties in Arbitration and Mediation

SEC Approves a Proposed Rule Change Relating to Representation of Parties in Arbitration and Mediation

Effective Date: December 24, 2007

Executive Summary

The SEC has approved amendments to Rule 12208 of the Code of Arbitration Procedure for Customer Disputes (Customer Code) and Rule 13208 of the Code of Arbitration Procedure for Industry Disputes (Industry Code), and has approved new Rule 14106 of the Code of Mediation Procedure to address representation of parties in arbitration and mediation cases.¹

The amendments apply to any case in which parties provide FINRA with notice of representation on or after December 24, 2007. If an attorney or representative files a pleading, or otherwise acts on behalf of a party in a case in the FINRA dispute resolution forum, then FINRA will consider these actions as sufficient notice of representation. If parties have provided such notice of representation to FINRA prior to the effective date, then the new rules do not apply. If they have not given such notice prior to the effective date, then the new rules do apply. The text of the amendment is set forth in Attachment A.

Questions concerning this *Notice* should be directed to Mignon McLemore, Assistant Chief Counsel, FINRA Dispute Resolution, at (202) 728-8151 or mignon.mclemore@finra.org.

November 2007

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Legal

Key Topics

- Arbitration
- Code of Arbitration Procedure
- Code of Mediation Procedure
- Dispute Resolution
- Mediation

Referenced Rules & Notices

- Rule 12208 (Customer Code)
- Rule 13208 (Industry Code)
- Rule 14106 (Mediation Code)

Background and Discussion

The rule changes clarify the issue of representation of parties in FINRA dispute resolution proceedings. The prior rules stated only that “all parties shall have the right to representation by counsel at any stage of the proceedings.” The rules did not provide any guidance on the kind of representatives who were permitted to practice in the dispute resolution forum; nor did they provide guidance on the qualifications those representatives must have to participate in the forum. Moreover, the prior rules did not address a growing trend in American jurisprudence: the multi-jurisdictional practice of law, which occurs when attorneys, licensed in one United States (U.S.) jurisdiction, practice law in a jurisdiction in which they are not licensed.

To address these issues, FINRA filed a proposal with the Securities and Exchange Commission (SEC) on September 14, 2006. Amendments 1 and 2 were filed on November 9, 2006 and February 23, 2007, respectively. The SEC published the proposal for comment in the *Federal Register* on April 13, 2007.² After FINRA submitted its response to comments, the SEC approved the proposal on September 26, 2007.³

FINRA has amended Rules 12208 and 13208 of the Customer and Industry Codes, respectively, and adopted Rule 14106 of the Mediation Code (referred to collectively as “the rules”) to address representation of parties in arbitration and mediation. The rules provide that:

- ▶ parties may represent themselves;
- ▶ parties may be represented by an attorney, provided certain criteria are met; or
- ▶ parties may be represented by a person who is not an attorney, unless state law prohibits such representation or the person is currently suspended or barred from the securities industry in any capacity, or is currently suspended from the practice of law or disbarred.

In addition, the rules provide that issues regarding qualifications of a representative are to be governed by applicable law.

Each provision of the changes to the rules is discussed below.

Representation by a Party

The rules codify current practice by explicitly stating that parties may represent themselves in an arbitration or mediation proceeding. Likewise, the rules state that a member of a partnership may represent a partnership; and a *bona fide* officer of a corporation, trust or association may represent the corporation, trust or association in an arbitration or mediation proceeding.

Representation by an Attorney

Parties may be represented in an arbitration or mediation by an attorney at law in good standing and admitted to practice in any jurisdiction in the U.S., including the District of Columbia, or any commonwealth, territory or possession of the U.S., unless state law prohibits such representation. Thus, under this provision, if a party chooses to be represented by an attorney, the attorney must be licensed to practice law in a U.S. jurisdiction, be in good standing and comply with the applicable laws of the U.S. jurisdiction in which the hearings are held.⁴

Under this provision, neither the staff nor the arbitration panel⁵ is required to verify the attorney's compliance with state law. If state law prohibits such representation, the parties may raise the issue with the panel. Parties also may seek court or regulatory agency relief. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

If a party chooses to be represented by an attorney, either the party or the attorney must notify FINRA in writing of the attorney's intent to appear, and provide the attorney's contact information.⁶ The party or attorney may satisfy this requirement by providing this information in the initial pleadings⁷ filed with the Director of Arbitration (Director) or by means of the online filing system (www.finra.org/onlineclaimfiling).⁸

Representation by Others

Parties may be represented in an arbitration or mediation by a person who is not an attorney, unless:

- state law prohibits such representation;
- the person is currently suspended or barred from the securities industry in any capacity; or
- the person is currently suspended from the practice of law or disbarred.

This provision allows a relative, friend or associate to represent or assist a person (*e.g.*, an elderly or disabled person) with his or her arbitration or mediation. Investors can also find affordable legal representation at law school securities arbitration clinics.⁹

Under this provision, neither the staff nor the arbitration panel is required to verify the non-attorney's compliance with state law. If state law prohibits such representation or if the non-attorney representative is currently (i) suspended or barred from the securities industry or (ii) suspended from the practice of law or disbarred, the parties may raise the issue with the panel. Parties also may seek court or regulatory agency relief. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

If a party chooses to be represented by a non-attorney representative, either the party or the representative must notify FINRA in writing and provide the representative's contact information. The party or representative may satisfy this requirement by providing this information in the initial pleadings filed with the Director or by means of the online filing system (www.finra.org/onlineclaimfiling).¹⁰

Effective Date Provisions

The amendments to Rules 12208 and 13208 of the Customer and Industry Codes, respectively, and new Rule 14106 of the Mediation Code will become effective on December 24, 2007, and will apply to any case in which parties provide FINRA with notice of representation on or after December 24, 2007. If an attorney or representative files a pleading, or otherwise acts on behalf of a party in a case in the FINRA dispute resolution forum, then FINRA will consider these actions as sufficient notice of representation. If parties have provided such notice of representation to FINRA prior to the effective date, then the new rules will not apply. If they have not given such notice prior to the effective date, then the new rules will apply.

Endnotes

1. Exchange Act Release No. 56540 (Sept. 26, 2007), 72 Federal Register 56410 (Oct. 3, 2007) (File No. SR-NASD-2006-109).
2. Exchange Act Release No. 55604 (April 9, 2007), 72 Federal Register 18703 (April 13, 2007).
3. See note 1.
4. While the multi-jurisdictional practice of law may be permitted in many jurisdictions, it may constitute a violation of certain states' unauthorized practice of law provisions.
5. The term "panel" means the arbitration panel, whether it consists of one or more arbitrators. See Rule 12100(q) of the Customer Code and Rule 13100(q) of the Industry Code.
6. If parties file an arbitration claim in California, their attorneys must provide a notice of intent to appear in the initial pleading submitted to FINRA Dispute Resolution. The notice in California arbitrations includes information similar to what is requested here. See FINRA's Notice to Attorneys and Parties Represented by Out-of-State Attorneys at www.finra.org/ArbitrationMediation/ResourcesforParties/NoticestoParties/index.htm.
7. A pleading is a statement describing a party's causes of action or defenses. The following documents are considered pleadings: a statement of claim, an answer, a counterclaim, a cross claim, a third-party claim and any replies.
8. In this case, if a party chooses to be represented by an attorney and the attorney files a pleading or otherwise acts on behalf of a party in the FINRA dispute resolution forum, then FINRA will consider these actions as sufficient notice of representation.
9. A securities arbitration clinic can help an investor who has a smaller claim but is unable to hire an attorney, provided the investor qualifies for assistance. For more information on clinic locations and eligibility requirements, see "How to Find an Attorney" at www.finra.org/ArbitrationMediation/StartanArbitrationorMediation/HowtoFindanAttorney/index.htm
10. In this case, if a party chooses to be represented by a person who is not an attorney and this representative files a pleading or otherwise acts on behalf of a party in the FINRA dispute resolution forum, then FINRA will consider these actions as sufficient notice of representation.

ATTACHMENT A

New language is underlined, deletions are in brackets.

Code of Arbitration Procedure for Customer Disputes, Code of Arbitration Procedure for Industry Disputes, and Code of Mediation Procedure

* * *

Customer Code

12208. Representation of Parties

(a) Representation by a Party

Parties may represent themselves in an arbitration held in a United States hearing location. A member of a partnership may represent the partnership; and a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association.

(b) Representation by an Attorney

At any stage of an arbitration proceeding held in a United States hearing location, all parties shall have the right to be represented by [counsel during any stage of an arbitration] an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States, unless state law prohibits such representation.

(c) Representation by Others

Parties may be represented in an arbitration by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or
- the person is currently suspended from the practice of law or disbarred.

(d) Qualifications of Representative

Issues regarding the qualifications of a person to represent a party in arbitration are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

Industry Code

13208. Representation of Parties

(a) Representation by a Party

Parties may represent themselves in an arbitration held in a United States hearing location. A member of a partnership may represent the partnership; and a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association.

(b) Representation by an Attorney

At any stage of an arbitration proceeding held in a United States hearing location, all parties shall have the right to be represented by [counsel during any stage of an arbitration] an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States, unless state law prohibits such representation.

(c) Representation by Others

Parties may be represented in an arbitration by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or
- the person is currently suspended from the practice of law or disbarred.

(d) Qualifications of Representative

Issues regarding the qualifications of a person to represent a party in arbitration are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the arbitration proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

* * *

Code of Mediation Procedure

14100 – 14105. No change.

14106. Representation of Parties

(a) Representation by a Party

Parties may represent themselves in mediation held in a United States hearing location. A member of a partnership may represent the partnership; and a bona fide officer of a corporation, trust, or association may represent the corporation, trust, or association.

(b) Representation by an Attorney

At any stage of a mediation proceeding held in a United States hearing location, all parties shall have the right to be represented by an attorney at law in good standing and admitted to practice before the Supreme Court of the United States or the highest court of any state of the United States, the District of Columbia, or any commonwealth, territory, or possession of the United States, unless state law prohibits such representation.

(c) Representation by Others

Parties may be represented in mediation by a person who is not an attorney, unless:

- state law prohibits such representation, or
- the person is currently suspended or barred from the securities industry in any capacity, or
- the person is currently suspended from the practice of law or disbarred.

(d) Qualifications of Representative

Issues regarding the qualifications of a person to represent a party in mediation are governed by applicable law and may be determined by an appropriate court or other regulatory agency. In the absence of a court order, the mediation proceeding shall not be stayed or otherwise delayed pending resolution of such issues.

[14106] 14107. Mediator Selection

(a) – (d) No change.

[14107] 14108. Limitation on Liability

No change.

[14108] 14109. Mediation Ground Rules

(a) – (g) No change.

[14109] 14110. Mediation Fees

(a) – (c) No change.

* * *

International Prime Brokerage

FINRA Solicits Comments on Proposed Guidance Regarding International Prime Brokerage Practices

Comment Period Expires: January 10, 2008

Executive Summary

Given the growth of the international prime brokerage (IPB) business, FINRA recently interviewed representatives from many of the largest prime brokerage firms to determine how this business is conducted. The interviews covered the various practices used by the prime brokers and how they differed from practices used in domestic prime brokerage, as outlined in the SEC's 1994 No-Action letter.¹ For purposes of this *Notice* and the Proposed Guidance, international prime brokerage is defined as the practice whereby a foreign domiciled customer executes transactions through a member firm (the executing broker) that are settled and carried by another member (the international prime brokerage custodian) on behalf of its affiliated foreign broker-dealer (the foreign prime broker or FPB).

FINRA's review found inconsistencies between member firms with regard to legal documentation/agreements, settlement practices, books and records, and other areas important in defining the roles and obligations of the parties when a prime broker customer (who is generally foreign domiciled) purchases or sells U.S. securities with a foreign prime broker and a U.S. executing broker.

In an attempt to establish consistency among our member firms, share best practices, and apply fair and consistent standards to all firms that are active in this business, FINRA is soliciting comments from member firms and other interested parties on our Proposed Guidance regarding the IPB practices described herein.

As outlined in Attachment A, the Proposed Guidance extends the existing requirements set forth by the SEC in the 1994 No-Action letter to IPB transactions relating to: (1) account arrangement, (2) delivery instructions, (3) affirmation of trades, (4) books and records, (5) documentation, (6) confirmation of trades, (7) notification and (8) net capital.

November 2007

Notice Type

- Request for Comment

Suggested Routing

- Compliance
- Legal
- Operations
- Senior Management

Key Topic(s)

- Foreign prime broker
- International Prime Brokerage

Referenced Rules and Notices

- SEC 1994 No-Action letter on prime brokerage
- SEC Rule 15c3-3
- SEC Rule 10b-10
- Reg SHO

Questions regarding this *Notice* should be directed to Bernadette Chichetti, Senior Principal Associate, Risk Oversight & Operations Regulation (RO&OR), at (212) 656-6934; or Yui Chan, Managing Director, RO&OR, at (212)656-8115.

Request for Comments

FINRA encourages all interested parties to comment on the Proposed Guidance. Comments must be received by January 10, 2008. Members and other interested parties can submit their comments using the following methods:

- Mailing comments in hard copy to the address below; or
- Emailing comments to pubcom@finra.org.

To help FINRA process and review comments more efficiently, you should only use one method to comment on this proposal; however, if you wish to submit comments using more than one of the methods listed above, you should indicate that in the submissions.

Comments sent by hard copy should be mailed to:

Barbara Z. Sweeney
Office of the Corporate Secretary
FINRA
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 FINRA Web site. Generally, comments will be posted on the FINRA Web site one week after the end of the comment period.²

Endnotes

1. See SEC No-Action letter of January 25, 1994 to SIA Prime Broker Committee.
2. 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. See *Notice to Members 03-73* (November 2003) (Online Availability of Comments) for more information.

ATTACHMENT A

International Prime Brokerage (IPB) Definitions:

- Foreign prime broker (FPB) is a foreign broker-dealer.
- Prime Broker Customers are foreign domiciled (PB customers).
- International Prime Broker Custodian (IPBC) is a carrying/clearing member which is an affiliate of and acts as custodian for the FPB in these international prime broker transactions.
- Executing broker (EB) is a member.
- Securities transactions are subject to applicable federal securities laws.

Proposed Guidance for IPB Best Practices

1. ACCOUNT ARRANGEMENT

The IPBC should enter into an omnibus cash account agreement with its FPB to establish an IPBC account for the aggregate trades of all the PB customers of the FPB. The IPBC will be responsible for affirmation and settlement for the PB customer transactions of the FPB and both the IPBC and the EB will be responsible for Reg. SHO compliance.

2. DELIVERY INSTRUCTION

The EB will direct the settlement of the transactions to be effected in the DTC account of the IPBC, which will settle the transactions on behalf of the FPB.

3. AFFIRMATION OF TRADES

The EB will confirm the trades, via the “Omgeo TradeSuite/CNS Interface for Prime Brokers,” with the IPBC. The PB customer, by T+1, will notify the FPB of the particulars of the trade. This data is then relayed by the FPB to the IPBC.

The IPBC, upon receipt of the trade data from the “Omgeo TradeSuite/CNS Interface for Prime Brokers,” will either affirm or DK the trade with the EB. In addition, consistent with the provisions of the 1994 No-Action letter,¹ the IPBC can disaffirm a previously affirmed trade. If the IPBC disaffirms or DKs a trade, then the transaction will continue to be treated as a customer transaction on the books of the EB. If the disaffirmed or DKed trade is a short sale, the EB will treat the transaction as if it had been executed in a customer margin account.

4. BOOKS & RECORDS

As stated above, the IPBC will establish an omnibus cash account in the name of the FPB on its books and records. This account will contain, in aggregate, all the trades for the PB customers of the FPB. On settlement date, this account should be paid in full. There are no restrictions on the FPB from withdrawing fully paid securities from this account.

Furthermore, the cash omnibus account established in the name of the FPB should be treated as a customer account by the IPBC for purposes of SEC Rule 15c3-3² and, thus, should be subject to the possession or control and customer reserve formula computation requirements of the rule. However, credit balances pertaining to any short sales should remain in a separate omnibus margin account in the name of the FPB in order to protect the IPBC from customer risk, as PB customers typically do not deposit margin with the FPB as customers of a foreign broker-dealer are exempt from the requirements of FRB Regulation T³ and other margin-related regulations. The FPB may enter into a separate securities borrowed transaction to cover the short sales in the margin omnibus account.

5. DOCUMENTATION

- Revised Form 150: Instead of an agreement between the FPB and EB, the IPBC should execute SIFMA Form 150 on International Prime Brokerage (SIFMA Form 150 may need to be revised) with the EB. In addition, the IPBC and its FPB should enter into a separate IPB agreement that specifies the obligations and responsibilities of each party in this custodian arrangement.
- Agreement between FPB and its PB Customers: The FPB should have an agreement with its PB customers.
- Revised Form 151: Agreement between the EB and its PB Customers: The EB should have an agreement (SIFMA Form 151 may need to be revised) with its customers that specifies the obligations and responsibilities of the parties regarding the IPB arrangement.
- Agreement between Introducing EB and its Carrying/Clearing Member: If the EB is an introducing member, it should inform its carrying/clearing firm that it intends to act as an EB in an IPB relationship. Furthermore, a contract must be executed between the introducing EB and its carrying/clearing member that specifies the obligations and responsibilities of each party in the IPB arrangement.

6. CONFIRMATION OF TRADES

The EB should send directly to the PB customer of the FPB a confirmation of each trade placed with the EB pursuant to this prime broker arrangement. Such confirmation should comply with the specific requirements of SEC Rule 10b-10.⁴ Alternatively, the EB may send the confirmation to the PB customer in care of the FPB if the PB customer has instructed the EB to do so in writing through an instrument separate from the prime broker agreement. In addition, on the day following the transaction, the FPB should send to the PB customer a notification of each trade placed with the EB under a prime broker arrangement, based upon information provided by the PB customer.

7. NOTIFICATION

The IPBC should notify its designated examining authority (DEA) in writing within thirty days from the date of issuance of the final guidance if it intends to act as an IPBC. In addition, any member firm intending to act as the EB in an IPB arrangement should provide written notice to its DEA prior to commencing such activity.

8. NET CAPITAL

- A member firm acting as an IPBC should have net capital of at least \$1,500,000.⁵
- A member firm acting as an EB clearing international prime broker transactions or a member firm clearing international prime broker transactions on behalf of an introducing EB should have net capital of at least \$1,000,000.⁶

Endnotes

1. See SEC No-Action letter of January 25, 1994 to SIA Prime Broker Committee.
2. 17 CFR 240.15c3-3
3. 12 CFR 220.1
4. 17 CFR 240.10b-10 and see SEC No-Action letter of January 25, 1994 to SIA Prime Broker Committee.
5. See SEC No-Action letter of January 25, 1994 to SIA Prime Broker Committee.
6. See Id.

Election Notice

FINRA Small Firm Advisory Board Election

November 1, 2007

Suggested Routing

- Executive Representatives
- Senior Management

Executive Summary

The purpose of this *Notice* is to inform FINRA Small Firm members¹ of the upcoming Small Firm Advisory Board (SFAB) election. The SFAB provides guidance to FINRA staff, particularly regarding the potential impact of proposed regulatory initiatives on FINRA's Small Firm members, and meets in Washington, DC, prior to each FINRA Board of Governors meeting. SFAB members are expected to attend SFAB meetings in person, as well as Regional and District Committee meetings and other FINRA meetings and functions. Potential candidates should ensure that their other commitments will allow for their in-person attendance at these events on a regular basis.

Five seats on the SFAB are up for election. Any eligible candidate wishing to have their name added to the ballot must submit the relevant information via the candidate profile form attached to this *Notice* to the Corporate Secretary of FINRA no later than Friday, November 30, 2007.

On or about Friday, December 14, 2007, FINRA will mail the official *Election Notice* and ballots to the Executive Representatives of Small Firm members to elect the five regional members of the SFAB. Voting will conclude in January 2008 and new members will take office in April 2008.

Composition of the FINRA Small Firm Advisory Board

Pursuant to a resolution of the FINRA Board of Governors, the composition of the SFAB has been revised. Beginning in April 2008, the SFAB will comprise ten members consisting of:

- ▶ five regional members elected by Small Firms in the five FINRA regions (one from each region); and
- ▶ five at-large members appointed by FINRA.

Additionally, the FINRA Board's Small Firm Governors² will serve as *ex-officio* members of the SFAB.

The five regional members up for election will represent the following geographic regions:

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

Candidate Eligibility

Any senior member of a Small Firm whose primary place of business is in the region in which his or her firm has its main office (as indicated in FINRA records) is eligible to have his or her name placed on the SFAB ballot for that region. Senior members of firms include owners, chief executive officers, presidents, chief compliance officers, chief operating officers or individuals of comparable status. Eligible individuals must complete the attached SFAB candidate profile form³ and submit it, through their firm's Executive Representative, to FINRA's Corporate Secretary. There may be only one candidate per firm on each ballot.

SFAB candidate profiles for the upcoming election must be received by the Corporate Secretary of FINRA no later than November 30, 2007.

FINRA's Corporate Secretary will confirm the firm's status as a Small Firm and the candidate's eligibility, and include certified candidates on the relevant region's ballot.

Individuals have a continuing obligation to satisfy the firm-size requirement on the date the candidacy is certified by the Corporate Secretary and the date the ballots are mailed. Individuals who fail to meet this requirement will be disqualified from election. SFAB members must also continue to meet their qualifications for election at all times during their terms of office.

Voting Eligibility

FINRA Small Firms are eligible to vote for candidates running for the SFAB seat representing the region corresponding to the district to which they are assigned in the Central Registration Depository.

The size of each firm and the location of each firm's main office will be verified on the day the ballots are mailed. Each firm will receive a ballot for the region in which it is eligible to vote. Firms may vote for only one candidate listed on the ballot.

Terms of SFAB Members

The successful candidate will be the individual who receives the most votes in their region. Eventually, all SFAB members will serve three-year terms. However, in order to maintain continuity on the SFAB going forward, the end of the terms of the individuals elected during this election will be staggered—and not all of them will serve for three years. Three-year terms will be phased in over the next three election cycles, with all SFAB members elected beginning with the 2009 election serving full three-year terms.

The schedule below shows the terms for persons to be elected in the upcoming election.

	Serves until December 31, 2010	Serves until December 31, 2009	Serves until December 31, 2008
Midwest Region			x
New York Region	x		
North Region		x	
South Region			x
West Region		x	

The term of an SFAB member shall terminate immediately upon a determination by the SFAB, by a majority vote of the remaining members, that the member no longer satisfies the eligibility criteria. Additionally, the FINRA Board may remove from the SFAB a member who is unable or fails to discharge the member's duties.

Once an individual has completed a full three-year elected term on the SFAB, he or she is ineligible to run for reelection to the SFAB for another three years.

District Elections

District Committee elections will be shortly after the SFAB election concludes. An *Election Notice* regarding the nomination and election process to fill vacancies on FINRA District Committees and District Nominating Committees will be disseminated on or about January 21, 2008.

Questions/Further Information

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

Barbara Z. Sweeney

Senior Vice President and Corporate Secretary
FINRA
1735 K Street, NW
Washington, DC 20006-1506
(202) 728-8062
(202) 728-8075 (fax)

or

T. Grant Callery

Executive Vice President and General Counsel
FINRA
1735 K Street, NW
Washington, DC 20006-1506
(202) 728-8285

Endnotes

- 1 A Small Firm is defined as a member that employs at least one and no more than 150 registered persons. *See* Article I (ww) of the FINRA By-Laws.
- 2 A Small Firm Governor is defined as a member of the FINRA Board elected by Small Firm members. In order to be eligible to serve, a Small Firm Governor must be registered with a member that is a Small Firm and must be an Industry Governor. *See* Article I (xx) of the FINRA By-Laws.
- 3 The SFAB candidate profile form is also available at www.finra.org/notices/election/110107

ATTACHMENT – Candidate Profile Form

Current Registration

Name: _____ CRD#: _____

Firm #: _____ RRs at Firm: _____

Title/Primary Responsibility: _____

Address: _____

City: _____ State: _____ Zip: _____

Phone: _____ Fax: _____

Email: _____

Prior Registration *(List the most recent first. Feel free to include extra pages if necessary.)*

Firm: _____

Title/Primary Responsibility: _____

Firm: _____

Title/Primary Responsibility: _____

General Areas of Expertise
(please check all that apply)

- Compliance/Legal
- Investment Advisory
- Corporate Finance
- Retail Sales
- Financial/Operational
- Trading/Market Making
- Institutional Sales
- Other

Product Expertise
(please check all that apply)

- Corporate Bonds
- Investment Company
- Direct Participation Programs
- Options
- Equity Securities
- Variable Contracts Securities
- Municipal/Government Securities
- Other

Memberships/Positions Held in Trade or Business Organizations

Past NASD/FINRA Experience and Dates of Service *(please check all that apply)*

- Committee Member
(Identify committee): _____ *Approx. Dates:* _____
- Arbitrator _____ *Approx. Dates:* _____
- Mediator _____ *Approx. Dates:* _____
- Expert Witness *(arbitrations; disciplinary proceedings)* _____ *Approx. Dates:* _____
- Other: _____ *Approx. Dates:* _____

Educational Background

School: _____ Degree: _____

School: _____ Degree: _____

Fax form to: (202) 728-8075

Information Notice

Continuing Education Planning

Executive Summary

In November 2007, the Securities Industry/Regulatory Council on Continuing Education (the Council) released the semi-annual Firm Element Advisory. The Council suggests that firms consult this guide when developing their Firm Element needs analysis.

FINRA's training resource library includes a range of online offerings that address many of the topics that the Council has outlined in the Firm Element Advisory and may be suitable for Firm Element training.

FINRA's online training resources for frontline staff are available in two formats:

- Webcasts – on-demand streaming video presentations that are generally 10 minutes in length. Webcasts are available at no charge and offer monthly completion tracking.
- E-Learning Courses – in-depth, 25- to 30-minute online courses with optional post-course assessments. E-Learning courses are available for a nominal charge and offer on-demand completion tracking and course completion certificates.

This *Notice* outlines the FINRA webcasts and e-learning courses that relate to specific Firm Element Advisory topics. Firms may find these resources useful as they develop their Firm Element training plans.

For more information about FINRA's online training courses, visit www.finra.org/webcast and www.finra.org/elearning.

November 26, 2007

Suggested Routing

- Compliance
- Continuing Education
- Legal
- Training

Key Topic(s)

- Continuing Education
- Firm Element

Referenced Rules & Notices

- Notice 07-56

**Firm Element
Advisory Topics**

FINRA Online Learning Options

Anti-Money Laundering

For frontline staff and supervisors:

Anti-Money Laundering:
Do You Know Your Customer? (Webcast)

Anti-Money Laundering:
Examples of Red Flags (Webcast)

Anti-Money Laundering – Retail (E-Learning Course)

Anti-Money Laundering – Retail: Exploring New Risks
(E-Learning Course)

Anti-Money Laundering – Retail: Recognizing and
Escalating Suspicious Activity (E-Learning Course)

Anti-Money Laundering – Retail: The Responsibility
to Know Your Customer (E-Learning Course)

For firms with institutional clients:

Anti-Money Laundering – Institutional
(E-Learning Course)

Anti-Money Laundering – Institutional:
Exploring New Risks (E-Learning Course)

Anti-Money Laundering – Institutional: Identification
and Reporting Issues (E-Learning Course)

Anti-Money Laundering – Institutional: Identifying
and Managing Higher-Risk Clients (E-Learning
Course)

Anti-Money Laundering – Institutional:
Know Your Customer (Webcast)

For operations staff:

Anti-Money Laundering: Responsibilities of
Operations Staff (E-Learning Course)

Anti-Money Laundering for Operations Staff
(Webcast)

Firm Element Advisory Topics	FINRA Online Learning Options
<p>Communications <i>Approval of Correspondence Electronic Communications (Supervision)</i></p> <p><i>Electronic Communications (Recordkeeping)</i></p>	<p>Communications with the Public: An Introduction to Compliance Issues (E-Learning Course)</p> <p>Communications with the Public: What a Registered Representative Should Know (Webcast)</p> <p>Books and Records (E-Learning Course)</p> <p>Books and Records: What a Registered Representative Needs to Know (Webcast)</p>
<p>Gifts and Business Entertainment <i>Gifts and Gratuities</i></p> <p><i>Influencing or Rewarding Employees of Others</i></p>	<p>Business Gifts (Webcast)</p> <p>Business Entertainment (Webcast)</p>
<p>Insurance Annuities <i>Life Settlements</i></p> <p><i>Sale of Unregistered Equity-Indexed Annuities</i></p>	<p>Life Settlements (Webcast)</p> <p>Equity-Indexed Annuities Considerations (Webcast)</p>
<p>Margin and Margin Accounts</p>	<p>Margin Accounts (Webcast)</p>
<p>Markups/Markdowns</p>	<p>Debt Mark-Ups (E-Learning Course)</p> <p>Debt Mark-Ups (Webcast)</p>
<p>Municipal Securities <i>Municipal Fund Securities Political Contributions and Solicitation of Municipal Securities Business</i></p>	<p>MSRB Issues (Webcast)</p>

**Firm Element
Advisory Topics**
FINRA Online Learning Options

<p>Sales Practices <i>Mutual Fund/Variable Annuity Sales Practices and Supervision</i></p> <p><i>New Products</i></p>	<p>Mutual Fund Breakpoints (Webcast)</p> <p>Mutual Funds Sales Practice: Share Classes and Breakpoints (E-Learning Course)</p> <p>Suitability Issues: Considerations for Product Exchanges (Webcast)</p> <p>Variable Annuity: Principal Review (Webcast)</p> <p>Variable Annuities: Sales Practice Issues for 1035 Exchanges (E-Learning Course)</p> <p>Variable Annuities: Suitability and Disclosure for New Purchases (E-Learning Course)</p> <p>Variable Annuities: Suitability Issues (Webcast)</p> <p>Equity-Indexed Annuity Considerations (Webcast)</p> <p>New Products Suitability Considerations (Webcast)</p> <p>Structured Products (Webcast)</p>
<p>Senior Investors</p>	<p>Considerations for Working with Seniors (Webcast)</p> <p>Retail Supervision: Emerging Investor Issues (E-Learning Course)</p> <p>Senior Investor Suitability Considerations (E-Learning Course)</p> <p>Supervisory Considerations for Working with Seniors (Webcast)</p>
<p>Supervision <i>Customer Complaints</i></p> <p><i>Supervising Recommendations of Newly Associated Registered Representatives to Sell a Product and Replace it with Another</i></p>	<p>Customer Complaint Handling (E-Learning Course)</p> <p>Suitability Issues: Considerations for Product Exchanges (Webcast)</p> <p>Variable Annuities: Sales Practice Issues for 1035 Exchanges (E-Learning Course)</p>

Disciplinary and Other FINRA Actions

Firms Fined, Individuals Sanctioned

Integrated Financial Planning Services (CRD #17935, Heidelberg, Germany) and Barry Ernest Swanson (CRD #706508, Registered Principal, Heidelberg, Germany) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$90,000, of which \$50,000 was jointly and severally with Swanson. Swanson was suspended from association with any FINRA member in any principal capacity for 20 business days. The firm and Swanson must review, revise and certify in writing to FINRA that the firm's written supervisory procedures are reasonably designed to achieve compliance with respect to on-base solicitation, continuing education, reporting and Anti-Money Laundering (AML) requirements. Without admitting or denying the findings, the firm and Swanson consented to the described sanctions and to the entry of findings that they failed to establish, maintain or enforce procedures reasonably designed to ensure compliance with federal regulations promulgated by the Department of Defense that govern commercial solicitation on military installations, and failed to establish an effective remote-site supervisory inspection program. The findings stated that the firm and Swanson failed to ensure that each non-registered office was examined on a regular basis at the remote location. The findings also stated that the firm did not have guidelines to identify or report potentially suspicious transactions; did not delineate steps to take to investigate suspicious activity; failed to adequately document the extent to which the firm's customer identification program was followed; failed to provide for independent testing of its compliance with its AML Compliance Program (AMLCP) and did not maintain adequate procedures for providing or conducting ongoing AML training. The findings also included that the firm and Swanson failed to timely disclose on Uniform Applications for Securities Industry Registration or Transfer (Forms U4) and to report to FINRA that the license of one of its registered representatives to solicit on military installations in Europe was suspended by the military for soliciting insurance sales on base without appropriate licensing from an insurance company unrelated to the firm.

FINRA found that the firm failed to timely report customer complaints to FINRA and did not have an effective supervisory system reasonably designed to preclude these reporting violations. FINRA also found that the firm, acting through Swanson, did not register locations as branch offices on a Uniform Application for Broker-Dealer Registration (Form BD) as required, and assigned responsibility for supervising registered representatives' activities at one or more non-branch locations to up to eight different supervisors at eight separate locations. In addition, FINRA found that the firm and Swanson failed to establish, maintain and enforce supervisory and compliance policies and procedures reasonably designed to achieve compliance with its reporting obligations. The findings further stated that the firm, acting through Swanson, permitted registered representatives who failed to complete the regulatory element of the Continuing Education (CE) program to conduct sales activities, failed to

Reported for November 2007

FINRA® 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).

develop the required annual written training plan and permitted a substantial number of registered representatives to avoid timely completion of the firm element of its CE program.

The findings stated that the firm and Swanson failed to supervise the contents of the firm's Web site and registered representatives' Web sites, and each Web site violated advertising rules in that the Web sites contained exaggerated and unwarranted claims about the registered representatives' expertise and the success clients could anticipate. The findings also stated that the firm's Web site also inaccurately stated that a large number of its representatives were Certified Financial Planners (CFPs), when only a small percentage were. In addition, the findings stated that the firm's Web site continued to show Swanson as a CFP for at least four months after he was no longer certified, and the firm did not adequately supervise these Web sites to detect and deter these violations. Moreover, the findings stated that the firm failed to retain all emails related to its business and certain customer account records. Furthermore, the firm failed to retain all emails for three years, the first two in an accessible place. In addition, FINRA found that the firm failed to preserve any customer account documentation and failed to implement an adequate supervisory system to ensure compliance with the books and records requirements of federal securities laws and NASD rules.

The suspension in any principal capacity was in effect from October 1, 2007, through October 26, 2007. (FINRA Case #SAF20040367)

Professional Investment Services, Inc. (CRD #13703, Winfield, Kansas) and Don Howard Ehling (CRD #76203, Registered Principal, Winfield, Kansas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000, jointly and severally with Ehling. Ehling was also suspended from association with any FINRA member in any and all principal capacities for 10 business days and required to requalify by examination as an introducing broker-dealer/financial and operations principal (Series 28) within 90 days. Without admitting or denying the findings, the firm and Ehling consented to the described sanctions and to the entry of findings that the firm, acting through Ehling, failed to timely file its annual audited financial report for one year.

The suspension in any principal capacity was in effect from October 1, 2007, through October 12, 2007. (FINRA Case #20070087996-01)

Firms Fined

Advanced Equities, Inc. (CRD #35545, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$31,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it reported Trade Reporting and Compliance Engine (TRACE)-eligible securities transactions late to TRACE. The findings stated that the firm failed to properly prepare order tickets for TRACE-eligible securities in that order tickets failed to show the entry time or receipt of customers' orders; order tickets failed to show the yield; order tickets were missing and one order ticket failed to show the trade time. The findings also stated that the firm failed to establish, maintain and enforce adequate written supervisory procedures reasonably designed to achieve

compliance with applicable transaction reporting requirements under NASD rules concerning TRACE reporting, and failed to maintain an adequate system of supervision reasonably designed to achieve compliance with the requirement to employ a registered options principal. The findings also included that the firm failed to qualify and register a Registered Options Principal for the supervision of options transactions in its customer options accounts, and failed to employ a Compliance Registered Options Principal to perform frequent appropriate supervisory review of its options business to ensure it was in compliance with securities laws, regulations and NASD rules. FINRA found that the firm failed to maintain an accurate Form BD in that it designated as the Senior Registered Options Principal an individual who was no longer associated with the firm. **(FINRA Case #2006003858201)**

Alpine Securities Corporation (CRD #14952, Salt Lake City, Utah) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report accurate trading information through the submission of electronic blue sheets in response to FINRA requests for such information, in that the firm failed to include the short sale indicator on electronic blue sheet records. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning the submission of electronic blue sheet data. **(FINRA Case #20050030784-02)**

Assent LLC (CRD #104162, Hoboken, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$16,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it accepted customer short orders through a trading platform for institutional customers, and for each order, failed to make 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. **(FINRA Case #20041000042-03)**

Assent LLC (CRD #104162, Hoboken, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$110,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it transmitted reports to the Order Audit Trail System (OATS) that contained inaccurate, incomplete or improperly formatted data because OATS was unable to match the reports to the identified receiving firm's related new order reports or to the related reports in SuperMontage or SelectNet. The findings stated that the firm failed to report the correct symbol indicating whether it executed transactions in eligible securities in a principal or agency capacity to the NASDAQ Market Center (NMC). The findings also stated that the firm transmitted reports to OATS that contained inaccurate, incomplete or improperly formatted data because it inaccurately denoted limit orders as market orders, and failed to include the time-in-force in new order reports. **(FINRA Case #20050014668-01)**

Bear, Stearns & Co., Inc. (CRD #79, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$25,500 and ordered to pay \$2,119.16, plus interest, in restitution to public customers. Without

admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it accepted customer short sale orders and failed to make an affirmative determination that the firm would receive delivery of the securities on the customers' behalf or that the firm could borrow the securities on the customers' behalf for delivery by settlement date. The findings stated that the firm effected short sales in securities for its proprietary accounts and failed to make an affirmative determination that the firm could borrow the securities or otherwise provide for delivery of the securities by settlement date. The findings also stated that the firm failed, within 90 seconds after execution, to transmit last sale reports of transactions in Consolidated Quotations Service (CQS) securities through the NMC. The findings also included that the firm failed to use reasonable diligence to ascertain the best inter-dealer markets for securities so that the resultant prices to its customers were as favorable as possible under prevailing market conditions. FINRA found that the firm failed to provide written notification disclosing to its customers that it was a market maker in each security, its correct capacity in transactions, and that transactions were executed at an average price; and incorrectly disclosed on a confirmation that the price the customer received was an average price. **(FINRA Case #20041000121-01)**

Crowell, Weedon & Co. (CRD #193, Los Angeles, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$27,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report information about customer transactions effected in municipal securities to the Real-time Transaction Reporting System (RTRS) because the firm failed to report information about the transactions within 15 minutes of Time of Trade to an RTRS Portal. The findings stated that the firm failed to report to RTRS the correct time of trade execution for transactions in municipal securities and failed to show the correct execution time on brokerage order memoranda. The findings also stated that the firm failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 15 minutes of execution time. The findings also included that the firm failed to promptly, accurately and completely report customer transactions in municipal securities to RTRS concerning the reported account number, accrued interest, allocation, price, quantity, Committee on Uniform Securities ID Procedure (CUSIP) number or settlement date. FINRA found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning municipal securities trade reporting and TRACE reporting, and MSRB rules concerning municipal securities trade reporting. **(FINRA Case #20050021855-01)**

CyberTrader, Inc. (CRD #44523, Austin, Texas) 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 submitted Route or Combined Order/Route Reports to OATS that the OATS system was unable to link to the corresponding new order submitted by the destination member firm due to inaccurate, incomplete or improperly formatted data. **(FINRA Case #20060039414-01)**

Deutsche Bank Securities, Inc. (CRD #2525, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000.

Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it submitted Reportable Order Events (ROEs) to OATS that OATS rejected for context or syntax errors, and that it failed to repair most of the rejected ROEs. (FINRA Case #20060047177-01)

Deutsche Bank Securities, Inc. (CRD #2525, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 15 minutes of execution time. (FINRA Case #20060060150-01)

EdgeTrade Inc. (CRD #42071, 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 submitted Route or Combined Order/Route Reports to OATS that the OATS system was unable to link to the corresponding new order submitted by the destination member firm due to inaccurate, incomplete or improperly formatted data. (FINRA Case #20050019130-01)

Finance 500, Inc. (CRD #12981, Irvine, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$42,000 and required to revise its written supervisory procedures regarding disclosure of order routing information; limit order protection; best execution; the three-quote rule; anti-intimidation and coordination; marking order tickets; affirmative determinations; Automated Confirmation Transaction Service (ACT) trade reporting; threshold securities; OATS; quotations for publication in the Pink Sheets; disclosure of order routing and execution information; trading in front of customer orders; NASD trade-through rules; short sales; locked and crossed markets; trading through quotes; and multiple quotations in different systems for the same security.

Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report the correct symbol indicating whether transactions were buy, sell, sell short, sell short exempt or cross for transactions in reportable securities to ACT (nka NMC). The findings stated that the firm submitted quotations for publication in a quotation medium (Pink Sheets) and did not have in its records the documentation required by SEC Rule 15c2-11(a) (Paragraph (a) information); did not have a reasonable basis under the circumstances for believing the information was accurate in all material respects and that the sources of the information were reliable; and the quotations did not represent a customer's indication of unsolicited interest. The findings also stated that for each quotation, the firm failed to file a Form 211 with FINRA at least three business days before the quotation was published or displayed in a quotation medium. The findings also included that the firm failed to report to ACT the correct symbol indicating whether it executed transactions in reportable securities in a principal or agency capacity and transmitted reports to OATS that contained inaccurate, incomplete or improperly formatted data. FINRA found that when the firm acted as principal for its own account, it failed to provide written notification disclosing to its customers that it was a market maker in each security; failed to provide written notification disclosing its correct capacity in transactions; and

failed to disclose a commission equivalent instead of a commission. FINRA also found that the firm failed to show the receipt time on brokerage order memoranda and the correct capacity of the firm on one brokerage order memorandum. In addition, FINRA determined that the firm executed short sale orders and failed to properly mark the order tickets as short, and executed long sales and improperly marked the order tickets as short sale exempt. Moreover, FINRA found that the firm failed to make a profit-sharing disclosure for internalized order flow on its vendor and firm generated SEC Rule 606 Reports; failed to disclose that the firm publishes multiple reports; failed to disclose on each report the identity of the other report; had reports that did not clearly explain the orders for which they applied; and failed to provide a hyperlink on its Web site to its vendor's Internet site where the firm had its report. Furthermore, the findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning disclosure of order routing information; limit order protection; best execution; the three-quote rule; anti-intimidation and coordination; marking order tickets; affirmative determinations; ACT trade reporting; threshold securities; OATS; quotations for publication in the Pink Sheets; disclosure of order routing and execution information; trading in front of customer orders; NASD trade-through rules; short sales; locked and crossed markets; trading through quotes; and multiple quotations in different systems for the same security. **(FINRA Case #20050005925-01)**

Financial Network Investment Corporation (CRD #13572, El Segundo, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$10,000 and required to revise its written supervisory procedures regarding reporting of transactions in TRACE-eligible securities. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 45 minutes of execution time. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning the reporting of transactions in TRACE-eligible securities. **(FINRA Case #20050001783-02)**

GFI Securities LLC (CRD #19982, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$25,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to accept or decline transactions in reportable securities in the NMC within 20 minutes after execution, when the firm had an obligation to accept or decline in the NMC as the Order Entry Firm (OEID). **(FINRA Case #20060041108-01)**

Hattier, Sanford & Reynoir, LLP (CRD #2148, Memphis, Tennessee) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it executed equity trades without employing a Series 55 Registered Equity Trader. The findings stated that the firm failed to report, and to timely report, municipal securities transactions to the MSRB. The findings also stated that the firm failed to report instances in which it had participated in negotiated municipal security underwriting activities. **(FINRA Case #2006003763601)**

Lehman Brothers Inc. (CRD #7506, New York, New York) 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 had a fail-to-deliver position in a threshold security at a registered clearing agency for 13 consecutive settlement days, and failed to immediately thereafter close out the fail-to-deliver position by purchasing securities of like kind and quantity. The findings stated that the firm continued to have a fail-to-deliver position which it failed to close out as required in the security at the registered clearing agency for 10 consecutive settlement days thereafter. **(FINRA Case #20050028026-01)**

Libertas Partners LLC (CRD #124790, Greenwich, Connecticut) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of the execution time. The findings stated that the firm failed to enforce its written supervisory procedures that specified that the designated supervisor would review transactions in TRACE-eligible securities on a daily basis for timeliness, completeness and accuracy, and would evidence the review by initialing internal reports or blotters. **(FINRA Case #20050014039-01)**

Moors & Cabot, Inc. (CRD #594, Boston, Massachusetts) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$40,000 and required to revise its written supervisory procedures regarding registration of employees, order handling, best execution, anti-competitive practices, trade reporting, short sale transactions, firm quote compliance, OATS, recordkeeping and information barriers. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to show the correct order entry time and/or execution time on brokerage order memoranda; failed to show the correct terms and conditions on brokerage order memoranda; and failed to preserve for a period of not less than three years, the first two in an accessible place, brokerage order memoranda. The findings stated that the firm transmitted reports to OATS that contained inaccurate, incomplete or improperly formatted data; and failed to provide written notification disclosing to its customers either its correct capacity in transactions, that it was a market maker in the security transacted, or that transactions were executed at an average price.

The findings also stated 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 number of shares "executed away," time required to execute orders and order type/size groupings. The findings also included that the firm failed to notify customers, in writing, at least annually, of the availability on request of information concerning the identity of the venue to which the customers' orders were routed for execution in the six months prior to the request. FINRA found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning registration of employees, order handling, best execution, anti-competitive practices, trade reporting, short sale transactions, firm quote compliance, OATS, recordkeeping and information barriers. **(FINRA Case #20050011914-01)**

Multi-Financial Securities Corporation (CRD #10299, Denver, Colorado) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$10,000 and required to revise its written supervisory procedures concerning TRACE reporting. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 45 minutes of execution time and also failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of the execution time. The findings stated that the firm failed to report the correct execution time for transactions in TRACE-eligible securities to TRACE. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning TRACE reporting. **(FINRA Case #20070085804-01)**

NBC Securities, Inc. (CRD #17870, Birmingham, Alabama) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it reported transactions in TRACE-eligible securities to TRACE that it was not required to report. The findings stated that the firm failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of the execution time. The findings also stated that the firm failed to enforce its written supervisory procedures that specified that the operations manager review daily TRACE reports to ensure compliance with reporting requirements. **(FINRA Case #20050020364-02)**

The O.N. Equity Sales Company (CRD #2936, Cincinnati, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities to TRACE that it was required to report. **(FINRA Case #20050024338-01)**

Penson Financial Services, Inc. (CRD #25866, Dallas, Texas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it permitted, without the customers' consent, the hypothecation of customer securities positions under circumstances that permitted the commingling of these securities positions with non-customer securities positions in order to collateralize bank loans. **(FINRA Case #E062005013001)**

Sammons Securities Company, LLC (CRD #115368, Ann Arbor, Michigan) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$10,500 and required to revise its written supervisory procedures with respect to reporting transactions to TRACE. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of execution time, and failed to report the correct trade execution time for transactions in TRACE-eligible securities to TRACE. The

findings stated that the firm failed to show the correct execution time on brokerage order memoranda. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning reporting transactions to TRACE. **(FINRA Case #20050015238-01)**

Seaboard Securities, Inc. (CRD #755, Florham Park, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$14,000 and required to revise its written supervisory procedures concerning accuracy of TRACE reporting. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report the lower of yield to call or yield to maturity for transactions in TRACE-eligible securities to TRACE, and failed to show the time of receipt, entry and execution on brokerage order memoranda. The findings stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning TRACE reporting accuracy. The findings also stated that the firm published quotations for over-the counter (OTC) equity securities or, directly or indirectly, submitted quotations for publication in a quotation medium (Pink Sheets) and did not have in its records the documentation required by SEC Rule 15c2-11(a) (Paragraph (a) information), and did not have a reasonable basis under the circumstances for believing the information was accurate in all material respects and the sources of the information were reliable. The findings included that the quotations did not represent a customer's indication of unsolicited interest. FINRA found that for each quotation, the firm failed to file a Form 211 with FINRA at least three business days before the quotation was published or displayed in a quotation medium. **(FINRA Case #20050001569-01)**

Susquehanna Capital Group (CRD #29337, Bala Cynwyd, Pennsylvania) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$55,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it transmitted reports to OATS that contained inaccurate, incomplete or improperly formatted data, and failed to report the yield for transactions in TRACE-eligible securities to TRACE. The findings stated that the firm failed to report short sale transactions to the NMC with a short sale modifier. The findings also stated that the firm failed, within 90 seconds after execution, to transmit through the NMC last sale reports of transactions in NNM, SmallCap (SC) and CQS securities; incorrectly designated as "PRP" through the NMC last sale reports of transactions in NASDAQ National Market (NNM), SC and CQS securities reported to the NMC and incorrectly designated as "SLD" through the NMC last sale reports of transactions in CQS securities reported to the NMC. **(FINRA Case #20050023569-01)**

Terra Nova Financial, LLC (CRD #37761, Chicago, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it transmitted reports to OATS that contained inaccurate, incomplete or improperly formatted data because OATS was unable to match the reports to the identified receiving firm's related new order reports. **(FINRA Case #20050014752-01)**

Thomas Weisel Partners, LLC (CRD #46237, San Francisco, California) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$40,000 and required to revise its written supervisory procedures with respect to registration and qualification of associated persons, order handling, best execution, trade reporting, sales transactions, firm quote and OATS. 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 the NMC the correct number of shares for transactions in eligible securities effected solely on the firm's program trading desk. The findings stated that the firm submitted orders to OATS that contained an inaccurate execution time; reports that incorrectly contained the reporting exception code "T"; and the firm failed to submit required information to OATS for one order. The findings also stated that the firm failed to mark its trading ledger as short or exempt. The findings also included that the firm failed to provide written notification disclosing to its customers its correct capacity in transactions, and incorrectly disclosed to its customers that transactions were executed at an average price when transactions were executed on a single execution. FINRA found that the firm failed to establish, maintain and/or enforce adequate written supervisory procedures for registration and qualification of associated persons, order handling, best execution, trade reporting, sales transactions, firm quote and OATS. (FINRA Case #20050021637-01)

Tradition Asiel Securities Inc. (CRD #28269, New York, New York) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report the correct execution time to NASDAQ in late, last sale reports of transactions in CQS securities and incorrectly designated the reports as "T." The findings stated that the firm failed, within 90 seconds after execution, to transmit to NASDAQ last sale reports of eligible securities and failed to designate them as late. (FINRA Case #20050017970-01)

UBS Financial Services Inc. (CRD #8174, Weehawken, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured, fined \$30,000 and ordered to pay \$11,630, plus interest, in restitution to public customers. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to use reasonable diligence in customer transactions to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant prices to its customers were as favorable as possible under prevailing market conditions. (FINRA Case #20050022470-01)

UVEST Financial Services Group, Inc. (CRD #13787, Charlotte, North Carolina) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$39,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that contrary to the firm's AMLCP, it failed to use exception reports to detect and report suspicious activity, relying on its clearing firm and occasional, unsolicited referrals from employees to detect suspicious activity. The findings stated that a member of the firm's senior management did not approve its AMLCP in writing, and the firm failed to include procedures to monitor for compliance with Section 311 of the USA PATRIOT Act. The findings also stated that the firm failed to inspect some of its Offices of Supervisory Jurisdiction (OSJ) at least annually and failed to inspect some of its non-OSJ branch offices at least once every

three years. The findings also included that the firm failed to enforce its written supervisory procedures concerning employee securities held outside the firm, and failed to maintain and evidence its review of employee statements showing securities accounts held outside the firm.

FINRA found that the firm failed to timely report customer complaints in quarterly reports to FINRA, failed to timely report a customer complaint that resulted in a settlement exceeding \$15,000, failed to timely file amendments to Forms U4, and failed to timely file amendments to the Uniform Termination Notice for Securities Industry Registration (Form U5) for a person formerly registered with the firm. **(FINRA Case #E072005012701)**

Weller, Anderson & Co., Ltd. (CRD #23736, Houston, Texas) submitted a Letter of Acceptance, Waiver and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that it failed to report transactions in TRACE-eligible securities executed on a business day during TRACE system hours to TRACE within 30 minutes of execution time, and failed to report transactions in TRACE-eligible securities executed at or after 6:30 p.m. Eastern Time through 11:59:59 p.m. Eastern Time to TRACE within 30 minutes after the TRACE system opened the next business day. The findings stated that the firm failed to enforce its written supervisory procedures with respect to TRACE trade reporting and failed to document that it conducted the review described in its written supervisory procedures. **(FINRA Case #20050004552-01)**

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 \$75,000. Without admitting or denying the findings, the firm consented to the described sanctions and to the entry of findings that its written AML procedures pertaining to the independent test FINRA required were not reasonably designed to determine that its written AML program and its implementation of the program satisfied NASD Rule 3011 because the procedures lacked specificity as to the nature and scope of the test; did not provide for the establishment and preservation of test records and did not indicate how the firm would respond to any deficiencies noted during the test. The findings stated that the firm's test of its AML program was inadequate in that it consisted of an interview of the firm's AML compliance officer by the individual retained to conduct the test. The findings also stated that the firm did not create and maintain AML training records for two years as required in its written AML program. The findings also included that the firm's written AML program did not incorporate practices and procedures the firm employed to detect and appropriately report suspicious activity in customer accounts; did not adequately address the risks customer accounts posed and did not describe its use of exception reports received from its clearing firms.

FINRA found that the firm's system and procedures for the preservation of electronic communications were not reasonably designed to cause the preservation of all required communications because it allowed for deletions prior to the once-monthly transfer of communications from individual mail boxes on the server to a permanent storage medium, and the firm did not conduct periodic retrospective reviews or "spot-checks" to determine whether its system was preserving communications in compliance with SEC Rule 17a-4. **(FINRA Case #20060037684-01)**

Wilson-Davis & Co., Inc. (CRD #3777, Salt Lake City, Utah) 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 report accurate trading information through the submission of electronic blue sheets in response to FINRA requests for such information. The findings stated that the firm failed to include the short sale indicator for electronic blue sheet records. The findings also stated that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules concerning the submission of electronic blue sheet data. (FINRA Case #20050025082-02)

Individuals Barred or Suspended

Thaddeus Edem Akloyo (CRD #5159766, Associated Person, Owing Mills, Maryland) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Akloyo failed to respond to FINRA requests for information. The findings stated that Akloyo willfully failed to disclose material information on his Form U4. (FINRA Case #2006005849101)

Quinton Allen Bailey (CRD #2969651, Registered Principal, Jamaica, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$15,000, suspended from association with any FINRA member in any capacity for one year and barred from association with any FINRA member in a supervisory/principal capacity. The fine must be paid either immediately upon Bailey's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Bailey consented to the described sanctions and to the entry of findings that he knowingly falsified, and caused to be falsified, records reflecting the supervisory review of daily trade blotters by backdating the blotters so that they appeared to have been reviewed within the time his member firm required. The findings stated that Bailey inaccurately certified that he completed supervisory reviews when he had not yet completed the reviews. The findings also stated that Bailey asked notaries public, who were employees of his member firm or its affiliate, to notarize signatures previously executed by customers who were not present in the office at the time of his requests and at least, on one occasion, his request was successful and a signature was improperly notarized.

The suspension in any capacity will be in effect from October 1, 2007, through September 30, 2008. (FINRA Case #2005002680801)

Stephen Kent Brombach (CRD #2004305, Registered Representative, Marysville, Washington) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Brombach consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior notice to, and approval from, his member firm. The findings stated that Brombach received funds for investment in a real estate investment trust (REIT) but did not direct the funds to the REIT as intended, thereby making improper use of customers' and investors' funds. The

findings also stated that Brombach issued account statements to investors that falsely represented that their funds had been placed in a REIT and that Brombach offered securities through his member firm and referred to the purported REIT as a financial holding with his firm, thereby misrepresenting to investors that their interests in a REIT were offered through and/or held by his firm. The findings also included that Brombach failed to respond to FINRA requests for information. **(FINRA Case #2006006326901)**

Marie Laurence Clerge (CRD #4045999, Associated Person, Wellington, Florida) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$10,000 and suspended from association with any FINRA member in any capacity for seven business days. Without admitting or denying the findings, Clerge consented to the described sanctions and to the entry of findings that she held the title of, and performed the duties of, Chief Compliance Officer of her member firm without being registered in the required general securities representative and general securities principal capacities.

The suspension in any capacity was in effect from October 15, 2007, through October 23, 2007. **(FINRA Case #E072005008601)**

Nicholas Arthur Connolly (CRD #4650966, Registered Representative, Plaistow, New Hampshire) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for six months. The fine must be paid either immediately upon Connolly's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Connolly consented to the described sanctions and to the entry of findings that without public customers' knowledge, authorization or consent, he signed their signatures on documentation in connection with the purchase of various insurance policies.

The suspension in any capacity is in effect from October 1, 2007, through March 31, 2008. **(FINRA Case #2006006759001)**

Kent Leroy Erickson (CRD #2218687, Registered Principal, Mount Vernon, Washington) submitted a Letter of Acceptance, Waiver and Consent in which he was suspended from association with any FINRA member in any capacity for one month. In light of Erickson's financial status, no monetary sanctions were imposed. Without admitting or denying the findings, Erickson consented to the described sanction and to the entry of findings that he borrowed \$2,000 from a public customer and subsequently repaid the loan in full even though his member firm did not have written procedures allowing the borrowing and lending of money between its registered persons and its customers.

The suspension in any capacity was in effect from October 1, 2007, through October 31, 2007. **(FINRA Case #2006006477301)**

Myrtle Jean Gilpin-Morgan (CRD #2804595, Registered Representative, Elmont, New York) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$10,000, suspended from association with any FINRA member in any capacity for one year and ordered to pay \$45,775.23, plus interest, in restitution to a public customer. The fine and restitution must be paid either immediately upon Gilpin-Morgan's

reassociation with a FINRA member firm following her suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Gilpin-Morgan consented to the described sanctions and to the entry of findings that she engaged in excessive and unsuitable trading in a public customer's Individual Retirement Account (IRA) of over which she exercised written discretionary authority, and was inconsistent with the investment objectives and financial situation and needs of the customer. The findings stated that Gilpin-Morgan settled, or attempted to settle, a customer complaint by sending the customer personal checks totaling \$6,000, without providing prior notice to her member firm regarding her settlement efforts with the customer.

The suspension in any capacity is in effect from October 15, 2007, through October 14, 2008. **(FINRA Case #2006006859201)**

Barbara Jill Guenther (CRD #2673244, Registered Representative, Cincinnati, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$5,000 and suspended from association with any FINRA member in any capacity for three months. The fine must be paid either immediately upon Guenther's reassociation with a FINRA member firm following her suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Guenther consented to the described sanctions and to the entry of findings that she signed a public customer's name on a document in order to effect a variable annuity replacement without the customer's knowledge or consent.

The suspension in any capacity is in effect from October 15, 2007, through January 14, 2008. **(FINRA Case #2006006285301)**

Earl David Glick (CRD #2248187, Registered Principal, Cortland, Illinois) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. Without admitting or denying the findings, Glick consented to the described sanctions and to the entry of findings that at the direction of a customer's relative, he made withdrawals totaling \$66,000 from a public customer's IRA without the customer's knowledge or consent. The findings stated that Glick effected the withdrawals in the absence of written or oral authorization to exercise discretion in the account and without a relative's authority, written or otherwise, to accept direction for trades in the customer's account.

The suspension in any capacity was in effect from October 1, 2007, through October 12, 2007. **(FINRA Case #2006005875701)**

William Ray Harrington (CRD #2786686, Registered Representative, Clearwater, Florida) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Harrington consented to the described sanction and to the entry of findings that his member firm's parent company issued him a corporate credit card to pay insurance agent and licensing fees to various state departments of insurance, but he used the credit card to convert to his own use and benefit \$119,721.91 of the insurance company's funds. **(FINRA Case #2006006445701)**

Jacqueline Denise Harris (CRD #3139400, Registered Principal, Highlands Ranch, Colorado) submitted a Letter of Acceptance, Waiver and Consent in which she was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Harris consented to the described sanction and to the entry of findings that she submitted expenses for reimbursement totaling \$5,000 to her member firm and represented that the corporate credit card expenditures were properly reimbursable business expenses when they actually consisted of personal expenses, previously reimbursed expenses and non-reimbursable expenses. The findings stated that Harris' firm subsequently reimbursed the improperly claimed expenses and Harris accepted the reimbursements. **(FINRA Case #2006005888601)**

Owen Robert Hubbs (CRD #3259714, Registered Representative, Kent, Washington) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$21,653.75, which included the disgorgement of \$1,653.75 in commissions received, and suspended from association with any FINRA member in any capacity for two years. The fine must be paid either immediately upon Hubbs' reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Hubbs consented to the described sanctions and to the entry of findings that he purchased, or caused to be purchased, mutual funds and shares in public customers' REIT account without the customers' knowledge or consent and in the absence of written or oral authorization to exercise discretion in the account.

The findings stated that in order to effect the purchase of the mutual funds and REIT shares, Hubbs wrote a more current date next to the signature of one of the customers, who was deceased, on a customer account transfer form, falsely implying that the customer had signed the form on that date. The findings stated that the form was made a part of Hubbs' member firm's books and records, causing a record of the firm to be falsified. The findings also included that in order to effect the purchase of the mutual fund and REIT shares, Hubbs affixed the deceased customer's signature and initials to an investment disclosure document and submitted the document and a "rationale" document which purportedly discussed the purchases with the deceased to his member firm, thereby misrepresenting the facts regarding the purchases to his firm and causing a firm record to be falsified.

The suspension in any capacity is in effect from October 1, 2007, through September 30, 2009. **(FINRA Case #2006005569701)**

Ivan N. Ilnitskiy (CRD #5281655, Associated Person, Redmond, Washington) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for three months. The fine must be paid either immediately upon Ilnitskiy's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Ilnitskiy consented to the described sanctions and to the entry of findings that he misrepresented a material fact on his Form U4.

The suspension in any capacity is in effect from October 1, 2007, through December 31, 2007. **(FINRA Case #2007008117501)**

Ronald William Jinings (CRD #1852470, Registered Representative, Redmond, Oregon) was barred from association with any FINRA member in any capacity and ordered to reimburse a public customer \$6,996.82, plus interest. The sanctions were based on findings that Jinings borrowed \$12,000 from a public customer in violation of his member firm's written policy prohibiting its registered representatives from borrowing money from a customer without the firm's prior approval unless the customer was a member of the representative's immediate family. The findings stated that Jinings failed to respond to FINRA requests for information. **(FINRA Case #2006003877901)**

Thomas George Karidas (CRD #1568680, Associated Person, Athens, Greece) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Karidas consented to the described sanction and to the entry of findings that he failed to respond to a FINRA request for an on-the-record interview. **(FINRA Case #2005002180701)**

Michael Joseph Knapp (CRD #1303926, Registered Principal, Grand Rapids, Minnesota) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Knapp consented to the described sanction and to the entry of findings that he engaged in private securities transactions without prior written notice to, or prior written approval from, his member firm. The findings stated that Knapp failed to respond to a FINRA request for an on-the-record interview. **(FINRA Case #20070076901-01)**

Barbara Ann Koontz (CRD #1487389, Registered Principal, Brownsville, Oregon) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$5,000 and suspended from association with any FINRA member in any capacity for 10 business days. Without admitting or denying the findings, Koontz consented to the described sanctions and to the entry of findings that she deposited \$200 into a public customer's bank account to settle a complaint regarding the delay in purchasing a fixed annuity and failed to inform her member firm of the settlement.

The suspension in any capacity was in effect from October 15, 2007, through October 26, 2007. **(FINRA Case #2006005879301)**

Marc Alan Levy (CRD #2369929, Registered Principal, Boynton Beach, Florida) submitted an Offer of Settlement in which he was fined \$20,000, which included disgorgement of \$1,468 in commissions, and suspended from association with any FINRA member in any capacity for two years. The fine must be paid either immediately upon Levy's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the allegations, Levy consented to the described sanctions and to the entry of findings that he participated in private securities transactions without prior written notice to, or prior written approval from, his member firm. The findings stated that Levy failed to respond to FINRA requests for documents and information.

The suspension in any capacity is in effect from October 1, 2007, through September 30, 2009. **(FINRA Case #2005003329101)**

Ellen Rose Lozinski (CRD #2372418, Registered Principal, Great River, New York) submitted a Letter of Acceptance, Waiver and Consent in which she was fined \$7,500 and suspended from association with any FINRA member in a principal capacity for 30 days. Without admitting or denying the findings, Lozinski consented to the described sanctions and to the entry of findings that a member firm, acting through Lozinski, conducted a securities business while under its minimum net capital requirement. The findings stated that Lozinski failed to establish, maintain and enforce written supervisory control policies and procedures pursuant to NASD Rule 3012 and ensure that the firm completed an annual certification, certifying that it had processes in place to establish, maintain, review, test and modify written compliance policies and written supervisory procedures to comply with applicable securities rules and regulations.

The suspension in a principal capacity was in effect from October 1, 2007, through October 30, 2007. **(FINRA Case #2006003892001)**

Michelle Marie Mayo (CRD #2403554, Registered Principal, Paw Paw, Michigan) was fined \$5,000 and suspended from association with any FINRA member in any capacity for one year. The fine is due and payable when, and if, Mayo seeks to return to the securities industry. The sanctions were based on findings that Mayo falsified employment documents her member firm used to determine individuals' sales aptitude to become insurance agents and registered representatives.

The suspension in any capacity is in effect from October 1, 2007, through September 30, 2008. **(FINRA Case #E8A2004103102)**

Jose Rafael Mirabal (CRD #4042589, Registered Representative, Weston, Florida) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Mirabal failed to respond to FINRA requests for information and to provide testimony. **(FINRA Case #2005002701701)**

Douglas Jerry Morris (CRD #2860318, Registered Representative, Bartlett, Tennessee) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Morris failed to amend his Form U4 with material information and failed to respond to FINRA requests for information. **(FINRA Case #2006006947401)**

Edward Ray Mounts (CRD #2738403, Registered Representative, South Charleston, West Virginia) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Mounts consented to the described sanction and to the entry of findings that he engaged in an outside business activity, for compensation, without providing prompt, written notice to his member firm. The findings stated that after Mounts was directed to terminate his relationship with the company with which he was conducting his outside business activity, he gave his firm a letter, purportedly from the company, confirming that the business transactions had been cancelled and that Mounts would no longer be associated with the company. The findings also stated that the letter was not from the company and did not accurately reflect the nature and extent of Mounts' continuing outside business activities. **(FINRA Case #2007007997801)**

Joey N. Perez (CRD #4739449, Registered Representative, Houston, Texas) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Perez issued a bank debit card on a public customer's bank account without the customer's knowledge or authorization. The findings stated that Perez gave the unauthorized debit card to an acquaintance who used the card on numerous occasions, causing unauthorized aggregate withdrawals of \$13,744 from the customer's bank account. The findings also stated that Perez failed to respond to FINRA requests for information and documents. **(FINRA Case #2006005690401)**

Jeffrey Charles Plunkett (CRD #2731884, Registered Principal, Tulsa, Oklahoma) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Plunkett drew checks on public customers' accounts by forging the customers' signatures on the checks and cashing the checks without the customers' authorization, knowledge or consent, thereby converting \$539,252 to his own use and benefit. The findings stated that Plunkett failed to respond to FINRA requests for information. **(FINRA Case #2005003235201)**

David Alexander Ricca (CRD #3202131, Registered Representative, Clifton, New Jersey) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Ricca received \$25,000 from a public customer for investment purposes and failed to invest the funds as directed, thereby converting the funds to his own use and benefit. The findings stated that Ricca borrowed \$25,000 from a public customer in contravention of his member firm's written policies and procedures, prohibiting employees from borrowing money from customers. The findings also stated that the firm was not aware of, and did not approve Ricca's loan from the customer. The findings also included that Ricca failed to respond to FINRA requests for information. **(FINRA Case #2006004672701)**

Joseph R. Rivera (CRD #2032077, Registered Representative, Sicklerville, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$5,000 and suspended from association with any FINRA member in any capacity for three months. The fine must be paid either immediately upon Rivera's reassociation with a FINRA member firm following his suspension, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Rivera consented to the described sanctions and to the entry of findings that he signed a public customer's initials and signature on a disclosure form without the customer's authorization or consent.

The suspension in any capacity is in effect from October 15, 2007, through January 14, 2008. **(FINRA Case #2006005957801)**

Mark J. Sanpietro (CRD #2794564, Registered Principal, Lincroft, New Jersey) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Sanpietro consented to the described sanction and to the entry of findings that he affixed a public customer's signature to a wire transfer authorization letter without the customer's authorization or consent. The findings stated that Sanpietro submitted false responses and a backdated document in response to FINRA's requests for information. **(FINRA Case #2006003836501)**

Brian Jonathon Schuster (CRD #2894479, Registered Principal, Syracuse, Nebraska) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Schuster consented to the described sanction and to the entry of findings that he made unsuitable recommendations to public customers without reasonable grounds for believing that such transactions were suitable for the customers in view of their financial situations, investment objectives and financial needs. The findings stated that to induce the purchase of securities, Schuster failed to disclose material facts that demonstrated the securities' risks and true financial conditions even though he had knowledge of such facts. **(FINRA Case #2006004949201)**

Todd William Sens (CRD #2558107, Registered Representative, Robbinsdale, Minnesota) submitted an Offer of Settlement in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the allegations, Sens consented to the described sanction and to the entry of findings that he received checks totaling \$3,528.60 from a public customer to pay life insurance premiums, failed to follow the customer's instructions and either cashed the checks or deposited them into his business checking account, and used the funds for his personal benefit. The findings stated that Sens failed to respond to FINRA requests for information. **(FINRA Case #20060050165-01)**

John Arthur Shalvey (CRD #1916061, Registered Principal, Westerville, Ohio) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Shalvey consented to the described sanction and to the entry of findings that he opened securities accounts with a different member firm and did not notify his member firm, or the other firm, in writing, of his association with each firm prior to opening the accounts. The findings stated that Shalvey engaged in securities trading in the account with public customers with the expectation that he would share in the anticipated profits (and losses) with the customers without prior written authorization from the customers or from his firm for this sharing arrangement. The findings also stated that Shalvey knowingly placed false information on his firm's annual compliance questionnaire and on another firm's official forms when he completed new account forms, falsely claiming that he did not maintain securities accounts away from his firm, that he was not associated with FINRA member firms and intentionally concealing the true beneficial ownership of the accounts he shared with customers. **(FINRA Case #2005002351201)**

Chung Dinh Tran aka Tony Tran (CRD #5032068, Associated Person, Alameda, California) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Tran willfully failed to disclose material information on his Form U4 and failed to respond to FINRA requests for documents and information. **(FINRA Case #20060051879-01)**

Tuyen Quang Tran (CRD #4239414, Registered Representative, Forth Worth, Texas) was barred from association with any FINRA member in any capacity. The sanction was based on findings that Tran failed to respond to FINRA requests for testimony. The findings stated that Tran falsified documents by knowingly submitting documents with

forged signatures and representing to his member firm that they were genuine. (FINRA Case #2006005100101)

Eugene Roy Umhafer (CRD #1076841 Registered Representative, North Bellmore, New York) submitted a Letter of Acceptance, Waiver and Consent in which he was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Umhafer consented to the described sanction and to the entry of findings that he accepted, endorsed and deposited into his own bank account checks totaling more than \$2,500 received from a public customer made payable directly to him with the understanding that Umhafer would use the funds to pay the customer's interest payments on loans against his whole life insurance policies. The findings stated that Umhafer purportedly used the funds deposited into his bank account to purchase money orders which he claimed he sent to his member firm, and failed to follow up and ensure that his member firm received the money orders that he allegedly purchased with the customer's funds and that the customer's funds were properly being applied to the customer's outstanding loan balances. The findings stated that Umhafer's member firm never received the money orders Umhafer allegedly purchased with the commingled funds. (FINRA Case #2006005642201)

Ashley Renee Vuagniaux (CRD #4480029, Registered Representative, Springfield, Missouri) submitted a Letter of Acceptance, Waiver and Consent in which she was barred from association with any FINRA member in any capacity. Without admitting or denying the findings, Vuagniaux consented to the described sanction and to the entry of findings that she made unauthorized charges of \$7,316.17 on the credit card of her direct supervisor's business and made unauthorized money transfers from the business' credit line account to the business' bank account and wrote unauthorized checks totaling \$3,150 from that account payable to herself, which she cashed. The findings stated that Vuagniaux took these actions without her direct supervisor's knowledge, authorization or consent. (FINRA Case #20070077039-01)

R. McClure Webb III (CRD #2609775, Registered Principal, Columbia, South Carolina) submitted a Letter of Acceptance, Waiver and Consent in which he was fined \$25,000, suspended from association with any FINRA member in any principal or supervisory capacity for one year and suspended from association with any FINRA member in any capacity for six months. The fine must be paid either immediately upon Webb's reassociation with a FINRA member firm following his suspensions, or prior to the filing of any application or request for relief from any statutory disqualification, whichever is earlier. Without admitting or denying the findings, Webb consented to the described sanctions and to the entry of findings that he failed to establish and maintain a system to supervise the activities of his member firm's registered representatives and associated persons reasonably designed to achieve compliance with applicable securities laws, regulations and NASD rules. The findings stated that Webb failed to develop adequate procedures regarding reviewing and retaining electronic mail and instant message communications and failed to develop adequate written supervisory procedures regarding the amendment of Forms U4 and Forms U5. The findings also stated that Webb failed to report, and to timely report, information regarding customer complaints to FINRA. The findings also included that Webb failed to amend, or to timely amend, Forms U4 and/or Forms U5 of several existing and former firm registered

representatives to disclose customer complaints. FINRA found that Webb failed to timely appear to provide on-the-record testimony to FINRA.

The suspension in any capacity is in effect from October 15, 2007, through April 14, 2008 and the suspension in a principal or supervisory capacity is in effect from October 15, 2007, through October 14, 2008. **(FINRA Case #E062005001601)**

Michael Kit Yong Yap (CRD #2124707, Registered Principal, San Francisco, California) was fined \$80,000, suspended from association with any FINRA member in any capacity for six months and ordered to requalify by examination before serving in any registered capacity. The sanctions were based on findings that Yap entered into an oral agreement with a potential customer whereby he would open an account in the customer's name at his member firm, fund the account and engage in day-trading for a period of time during which Yap would cover all potential losses in the account. The findings stated that Yap failed to disclose his beneficial ownership in the customer's account to his member firm. The findings also stated that Yap failed to obtain written authorization from the customer and written acceptance from his firm to exercise discretion in the account.

The suspension in any capacity is in effect from October 1, 2007, through April 29, 2008. **(FINRA Case #E0120040004-01)**

Decision Issued

The Office of Hearing Officers (OHO) issued the following decision, which has been appealed to or called for review by the NAC as of September 30, 2007. The NAC may increase, decrease, modify or reverse the findings and sanctions imposed in the decision. Initial decisions which time for appeal has not yet expired will be reported in the next FINRA Notices.

Domestic Securities, Inc. (CRD #34721, Montvale, New Jersey) was fined \$10,000 and required to retain an independent consultant to conduct a prompt review of its AML program and its implementation of that program. The findings stated that the firm failed to develop and implement an AML program reasonably designed to achieve and monitor compliance with the requirements of the Bank Secrecy Act and the implementing regulations promulgated thereunder.

This decision has been called for review by the National Adjudicatory Council (NAC) and the sanctions are not in effect pending consideration of the review. **(FINRA Case# 2005001819101)**

Complaints Filed

FINRA issued the following complaints. Issuance of a disciplinary complaint represents FINRA'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.

Jerry William Burch (CRD #1450138, Registered Principal, Newport Coast, California) was named as a respondent in a FINRA complaint alleging that he recommended the purchase of a common stock without disclosing his material adverse interest. The complaint alleges that Burch, directly or indirectly, by use of means or instrumentalities of interstate commerce, intentionally or recklessly employed a device, scheme or artifice to defraud or engaged in an act, practice or course of business which operated or would operate as a fraud or deceit in connection with the purchase or sale of a security. The complaint also alleges that Burch failed to notify his member firm, in writing, of the existence of an account in which he had a financial interest and failed to notify the other member firm, in writing, of his association with a member firm. The complaint further alleges that Burch falsely told his member firm that customer purchases of a stock were unsolicited or otherwise failed to disclose that he solicited his customers' purchase of the stock; and created false, inaccurate or misleading firm records that his customers' purchases of the stock were unsolicited when, in fact, he had solicited customers. In addition, the complaint alleges that Burch willfully failed to amend his Form U4 with material information. **(FINRA Case #2005000324301)**

Richard Alan Daniels (CRD #60736, Registered Representative, Chagrin Falls, Ohio) was named as a respondent in a FINRA complaint alleging that he sold unregistered securities to public customers that did not have the represented purpose of generating extraordinary profitable returns for investors, but rather had the purpose of promoting an illegal Ponzi scheme and supporting Daniels' personal debts and expenses. The complaint alleges that Daniels falsely represented, orally and in writing, that customer funds would be invested and used to purchase interest bearing promissory notes and that the promissory notes were low to zero risk and were achieving returns. The complaint also alleges that Daniels embezzled funds from existing clients who had legitimate securities accounts on which he was the sales representative of record and forged their signatures on withdrawal requests and wire transfer authorizations without disclosing this to his member firm or the clients. The complaint further alleges that Daniels, directly or indirectly, by use of means or instrumentalities of interstate commerce, intentionally or recklessly employed a device, scheme or artifice to defraud or engaged in an act, practice or course of business that operated or would operate as a fraud or deceit in connection with the purchase or sale of a security. In addition, the complaint alleges that Daniels failed to fully respond to FINRA requests for information. **(FINRA Case #2005003642901)**

Scott Howard Weissman (CRD #2664118, Registered Representative, Miami, Florida) was named as a respondent in a FINRA complaint alleging that, without the knowledge or consent of a public customer, he instructed his member firm's clearing firm to transfer \$30,000 from the customer's brokerage account to a bank account for a movie production company of which Weissman was president. The complaint alleges that Weissman completed a wire-transfer instruction form, without the customer's knowledge or consent, which he faxed to the clearing firm and had a relative sign his name on the space provided above the customer's printed name and Weissman printed and signed his own name below the customer's printed name. The complaint also alleges that when the customer discovered the fund transfer, Weissman represented to the customer that the wire transfer was in error but failed to return all the funds to the customer. The complaint further alleges that without the knowledge or consent of public customers, Weissman faxed a wire-transfer instruction form to the clearing firm

authorizing the transfer of \$8,000 from the public customers' joint account to a bank account for the purchase of a common stock that the customers were not interested in purchasing and failed to return the funds after one of the customers noticed the stock purchase in the account. In addition, the complaint alleges that Weissman sold shares of a common stock that was not registered with the SEC and was not exempt from registration. The complaint also alleges that Weissman earned \$304,206 from the sales of the unregistered security. **(FINRA Case #2005001067201)**

Firm 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 – September 17, 2007)

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

(If the revocation has been rescinded, the date follows the revocation date.)

Mark W. Bender
Webster, New York
(September 13, 2007)

Patricia Wolff Schaen
New York, New York
(September 13, 2007)

Individuals Barred Pursuant to NASD Rule 9552(h)

(If the bar has been vacated, the date follows the bar date.)

Michael Edward Armentrout
Washington, DC
(September 13, 2007)

Shawn Clay
Charlevoix, Michigan
(September 26, 2007)

Warren Craig Coetzer
Fort Worth, Texas
(September 4, 2007)

James Jameke Eady
Brooklyn, New York
(September 18, 2007)

Nicholas David Glogovac
Los Angeles, California
(September 19, 2007)

Angel R. Gomez
SW Ranches, Florida
(September 19, 2007)

William Anthony Kaso
Penbroke Pines, Florida
(September 4, 2007 – October 23, 2007)

Calvin L. Kelle
Quincy, Illinois
(September 28, 2007)

Michael Pica Jr.
Franklin Square, New York
(September 4, 2007)

Lori Elizabeth Zoval
Stateline, Nevada
(September 20, 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.)

Barry Lee Bellan
South Bend, Indiana
(September 17, 2007)

Randy Scott Plumley
Blossvale, New York
(September 11, 2007)

Tiffany Lynne Simon
Columbus, Ohio
(September 4, 2007)

John Andrew Trout
St. Claire Shores, Michigan
(September 12, 2007)

Todd Allyn Williams
Akron, Ohio
(September 17, 2007)

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

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

Robert Wayne Blauvelt
Hamilton, Georgia
(September 5, 2007)

Dwight Oneal Fulton Jr.
Fort Lauderdale, Florida
(September 18, 2007)

Mark Goldberg
Middle Village, New York
(April 20, 2007 - September 25, 2007)

Nicholas Tarcher Krantz
North Hollywood, California
(September 5, 2007)

Kevin W. Parsells
Holmdel, New Jersey
(September 26, 2007)

Steven Lawrence Schlesinger
New York, New York
(September 26, 2007)

Theodore Francis Staats
Wexford, Pennsylvania
(September 20, 2007)

Gil Eugene Tallman
Fort Wayne, Indiana
(August 31, 2007)

FINRA Fines AXA Advisors \$1.2 Million for Fee-Based Account Violations, Orders Return of \$1.4 Million in Fees to Approximately 1,800 Customers

Firm Voluntarily Adds \$1.2 Million to Customer Refund Fund

The Financial Industry Regulatory Authority (FINRA) has fined AXA Advisors, LLC, \$1.2 million for failing to adequately supervise its fee-based brokerage business and distributing misleading sales literature for its fee-based brokerage account program, CapAdvantage, between 2001 and 2005.

FINRA also ordered AXA Advisors to return \$1.4 million in fees to approximately 1,800 customers who were inappropriately placed or kept in fee-based brokerage accounts. The firm is voluntarily refunding customers an additional \$1.2 million, making the total amount returned to CapAdvantage customers more than \$2.6 million. AXA Advisors also unilaterally took steps to enhance its system and procedures and to close accounts that were not appropriate for CapAdvantage. FINRA considered these steps taken by AXA Advisors in determining the sanctions in this case.

"When a firm offers a new service to customers, such as a fee-based brokerage account, it must tailor its supervisory systems to the newly offered product," said Susan L. Merrill, FINRA Executive Vice President and Chief of Enforcement. "AXA Advisors failed to put in place supervisory systems designed to ensure that its CapAdvantage fee-based account was appropriate for the customers it placed in the program. The firm also provided inaccurate information to brokers and customers about how fees would be assessed in these accounts."

In fee-based brokerage accounts, customers are charged an annual fee that is usually a percentage of the assets in the account with an annual minimum, rather than a commission for each transaction as in a traditional brokerage account. As a result, the compensation earned by the firm and the broker is generally not dependent on whether a customer buys or sells securities. These accounts first became available in 1999 as a result of a proposed Securities and Exchange Commission (SEC) rule that exempted brokers from certain elements of the Investment Advisers Act of 1940. In March of this year, a federal court struck down the final version of that SEC rule.

FINRA found that during the period when AXA Advisors developed CapAdvantage, prior to its 2001 launch, the firm was aware that fee-based brokerage accounts raised new supervisory and compliance issues. AXA Advisors designed the product for investors with a minimum balance of \$50,000 and who were not "buy-and-hold" investors, but who would engage in at least some trading. While the firm instructed its brokers that low balance accounts, infrequently traded accounts, and several other classes of accounts required close monitoring, it failed to adequately supervise for these issues.

FINRA found that the firm's system and procedures were not reasonably designed to determine whether the program initially was, or remained, appropriate for customers opening CapAdvantage accounts. One result of this was that AXA Advisors allowed many investors with less than \$50,000 in assets to open CapAdvantage accounts. For example, one customer opened a fee-based account with just \$2,000 and AXA Advisors assessed fees until the account was depleted of all funds. The firm also allowed numerous customers to maintain accounts in the program and pay for those accounts

even though they did no trading for years. For example, one customer maintained an average account balance of more than \$3.5 million, but did no trades from 2002 through 2004. Yet, during that period, the firm deducted approximately \$73,000 in asset-based fees.

It took AXA Advisors almost three years after introducing CapAdvantage to generate exception reports targeting its fee-based brokerage accounts. FINRA found that even after the creation of these reports, the firm did not have adequate follow-up. This was particularly egregious because approximately half of all CapAdvantage accounts appeared on an exception report that highlighted some of these issues.

In addition, FINRA found that AXA Advisors used written internal and external communications that were misleading. The firm told brokers and clients that CapAdvantage accounts would not be charged asset-based fees until the account reached \$50,000. While this accurately reflected the firm's initial intention, it did not reflect how fees were actually charged. In fact, over 1,500 customers were charged fees before reaching the "minimum" account level.

The firm's communications also asserted that a benefit of CapAdvantage was that the interests of the client and the broker were aligned, because the broker's compensation was not linked to the number of transactions in the account. However, the firm required brokers to partially absorb ticket charges, so brokers made less money with each transaction, creating a potential conflict of interest between the broker and the client, particularly for clients with the least assets in these accounts.

Under the terms of the settlement, customers who will receive refunds either did no trades for two years, or had less than the required minimum account balance for a year and were charged fees, or were charged fees prior to reaching the asset level that the firm said would trigger asset-based fees. Of the refunds ordered by FINRA, approximately \$812,000 is being returned to 1,500 small account holders who were allowed to open a fee-based brokerage account with less than the required \$50,000 minimum.

In settling this matter, the firm neither admitted nor denied the charges, but consented to the entry of FINRA's findings.

Morgan Stanley to Pay \$12.5 Million to Resolve FINRA Charges that it Failed to Provide Documents to Arbitration Claimants, Regulators

\$9.5 Million Fund to Be Established to Pay Arbitration Claimants for Discovery Violations, Firm to Pay \$3 Million Fine for Failing to Provide Pre-9/11 Emails and Supervisory Materials

The Financial Industry Regulatory Authority (FINRA) announced a settlement with Morgan Stanley & Co. to resolve charges that the firm's former affiliate, Morgan Stanley DW, Inc. (MSDW), failed on numerous occasions to provide emails to claimants in arbitration proceedings as well as to regulators - while representing that the destruction of the firm's email servers in the Sept. 11, 2001 terrorist attacks on New York's World Trade Center resulted in the loss of all pre-9/11 email. In fact, the firm had millions of pre-9/11 emails that had been restored to the firm's active email system using back-up tapes that had been stored in another location.

The settlement also resolves additional charges relating to the firm's failure to provide required supervisory materials to numerous arbitration claimants. The settlement announced today is the first of its kind—in that it provides for distribution of \$9.5 million to two groups of customers who had arbitration claims against the firm. FINRA estimates that several thousand customers may be eligible to receive payments. FINRA also imposed a \$3 million fine on the firm for its failure to provide pre-9/11 emails and updates to a supervisory manual.

"The integrity of our process demands that brokerage firms comply with their obligations to search diligently for, and provide in a timely way, information and documents required in arbitration proceedings and regulatory investigations," said Susan Merrill, FINRA Executive Vice President and Chief of Enforcement. "The action announced today underscores FINRA's commitment to ensuring that firms live up to those obligations. We are particularly pleased that this unique settlement directs the bulk of the monetary sanction to the customers in arbitrations, to remedy MSDW's discovery failures."

MSDW was merged into Morgan Stanley & Co. in April 2007. The former NASD, which consolidated with the member regulation functions of New York Stock Exchange Regulation in July to form FINRA, issued formal charges against MSDW in a complaint filed in December 2006.

Under the terms of the settlement, Morgan Stanley will deposit \$9.5 million into a fund to pay arbitration claimants for the discovery failures. All fund expenses, as well as the cost of hiring and compensating a fund administrator acceptable to FINRA, will be borne by the firm. The fund administrator will identify and notify potentially eligible arbitration claimants. Eligible claimants in the email aspect of the case can elect to receive a standard payment estimated to be between \$3,000 and \$5,000, or may choose to require Morgan Stanley to produce relevant emails still in its possession. A claimant who demands email production can decide to accept the standard payment - or waive that payment and have the fund administrator determine the amount, if any,

that the claimant should receive depending on the particular facts and circumstances of that individual case. Maximum payment in cases decided by the fund administrator cannot exceed \$20,000.

Eligible claimants who were denied the required supervisory materials will receive payments expected to be between \$1,500 and \$2,500. Some claimants may be eligible for payments as to both the pre-9/11 email and the failure to receive supervisory materials.

Detailed information about which arbitration claimants are eligible for fund payments, and about the claims process itself, can be found on the Arbitration Discovery Fund page of FINRA's Web site, www.finra.org.

Also as part of the settlement announced today, Morgan Stanley is required—again, at its own expense—to retain an independent consultant acceptable to FINRA to review the firm's procedures for complying with discovery requirements in arbitration proceedings relating to the firm's retail brokerage operations. The firm will be required to implement the independent consultant's recommendations for improving those procedures, or alternative improvements acceptable to the independent consultant.

FINRA found that MSDW failed to provide pre-9/11 emails to claimants in numerous arbitration proceedings and in response to three regulatory inquiries during the period from October 2001 through March 2005. FINRA found that MSDW made statements in numerous arbitration proceedings and to the former NASD, New York Stock Exchange Regulation and the Massachusetts Securities Division that those emails had been destroyed. Those statements were not true. In fact, MSDW possessed millions of pre-9/11 emails that had been restored to the firm's system shortly after Sept. 11, 2001 using backup tapes. Many other emails were maintained on individual users' computers and had not been affected by the events of 9/11. Among the matters where MSDW failed to produce e-mail was an NASD investigation that resulted in an August 2005 settlement with the firm.

FINRA also found that MSDW later destroyed many of the pre-9/11 emails it did possess. The firm did so in two ways—by overwriting backup tapes that had been used to restore the emails from 11 of its 12 servers to the firm's system, and by allowing users of the firm's email system to permanently delete the emails over an extended period of time. As a result, between September 2001 and March 2005, MSDW deleted millions of pre-9/11 emails from the firm's systems.

In addition, FINRA found that MSDW failed to provide updates to the firm's supervisory manual for branch office managers to claimants in numerous arbitration proceedings over a period of years. The Branch Manager's Manual was issued in 1994 and was subsequently supplemented with numerous updates. FINRA found, however, that MSDW repeatedly failed to provide updates to the manual in discovery in numerous arbitration proceedings from late 1999 through the end of 2005.

In settling this matter, Morgan Stanley neither admitted nor denied the charges, but consented to the entry of FINRA's findings.