

JANUARY 2005

Notice to Members

Notices

- 05-01** Final Renewal Statements and Reports
- 05-02** Stage Two of the Expansion of Dissemination of TRACE Transaction Data to Begin on February 7, 2005 Instead of February 1, 2005
- 05-03** NASD Provides Updated Options Exemption Listing for the Trading Activity Fee
- 05-04** SEC Approves Amendments to NASD Rule 2830(k) to Strengthen Prohibitions on Investment Company Directed Brokerage Arrangements; **Effective Date: February 14, 2005**
- 05-05** NASD Eliminates the TRACE Bond Transaction Data Service (BTDS) Non-Professional Real-Time Data Display Fee and the BTDS Professional Delayed-Time Data Display Fee Pilot Program
- 05-06** Exemption for Delta Neutral Positions of OTC Derivatives Dealers; **Effective Date: February 28, 2005**
- 05-07** SEC Approves Amendments to Rule 2212 Concerning Frequency of Updates From the National Do-Not-Call Registry; **Effective Date: March 1, 2005**
- 05-08** Guidance Regarding the Application of the Supervisory Control Amendments to Members' Securities Activities, Including Members' Institutional Securities Activities

continued



-
- 05-09** NASD Amends Rule Governing Predispute Arbitration Agreements with Customers;
Effective Date: May 1, 2005
- 05-10** NASD Amends Rule Governing Time Limits for Submission of Arbitration Claims;
Effective Date: May 1, 2005

Disciplinary and Other NASD Actions

D1

©2005. NASD. All rights reserved.

NASD Notices to Members is published monthly by NASD Corporate Communications, 1735 K Street, NW, Washington, DC 20006-1500, (202) 728-8370. No portion of this publication may be copied, photocopied, or duplicated in any form or by any means, except as described below, without prior written consent of NASD. Members of NASD are authorized to photocopy or otherwise duplicate any part of this publication without charge only for internal use by the member and its associated persons. Nonmembers of NASD may obtain permission to photocopy for internal use through the Copyright Clearance Center (CCC) for a \$3-per-page fee to be paid directly to CCC, 222 Rosewood Drive, Danvers, MA 01923.

Each member firm's Executive Representative is entitled to one annual subscription to *Notices to Members* at cost (\$15 per year). Additional annual subscriptions are available for \$225; single issues cost \$25. To order, send a check or money order (payable to NASD) to NASD MediaSource, P.O. Box 9403, Gaithersburg, MD 20898-9403; to order with a credit card (American Express, MasterCard, or Visa), call (240) 386-4200, Monday to Friday, 9 a.m. to 5 p.m., Eastern Time. Back issues may be ordered by calling MediaSource at (240) 386-4200. Subscribers with questions or concerns may contact NASD Corporate Communications at gina.cherry@nasd.com. To make an address change, please contact NASD's CRD Department at (301) 590-6500, or log on to the NASD Contact System at www.nasdr.com/ncs.asp#NCS_Access.

Notices to Members (December 1996 to current) are also available on the Internet at www.nasd.com.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Executive Representatives
Legal & Compliance
Operations
Registered Representative
Registration
Senior Management

KEY TOPICS

Registration
Renewals
Web CRD®
IARDSM
Maintenance Fees

GUIDANCE

Broker-Dealer, Investment Adviser and Individual (AG/RA) Renewals 2005

Final Renewal Statements and Reports

Executive Summary

The 2005 NASD Broker-Dealer and Investment Adviser Registration Renewal Program began its second phase this month. NASD is issuing this *Notice* to help firms review, reconcile, and respond to the Final Renewal Statements and Reports that are currently available on Web CRD/IARD.

Questions/Further Information

Questions regarding this *Notice* may be directed to the Gateway Call Center at (301) 869-6699.

Final Renewal Statements and Reports

On January 3, 2005, Final Renewal Statements and Reports became available for viewing and printing on Web CRD/IARD. The 2005 Final Renewal Statement reflects the final status of agent, investment adviser representative and firm registrations and/or Notice Filings as of December 31, 2004. Any adjustments in fees owed as a result of registration terminations, approvals, firm IA registrations or Notice Filings, subsequent to the Preliminary Renewal Statement have been made in this final reconciled statement.

If a firm had more agents, investment adviser representatives, branch offices, or additional registrations, or Notice Filings on Web CRD/IARD at year's end than it did on November 6, 2004, when the Preliminary Renewal Statement was generated, additional fees were assessed. If a firm had fewer agents, investment adviser representatives, or branch offices, registrations, and/or Notice Filings at year's end than it did when the preliminary Renewal Statement was generated, a credit was applied to the firm's Daily Account.

The 2005 Final Renewal Statements reflect the year-end 2004 total fees (where applicable) for:

Web CRD/IARD System Processing Fees

- ◆ NASD Branch Office Fees
- ◆ American Stock Exchange (AMEX), Chicago Board Options Exchange (CBOE), International Securities Exchange (ISE), New York Stock Exchange (NYSE), Pacific Exchange (PCX), and Philadelphia Stock Exchange (PHLX) Maintenance Fees
- ◆ Jurisdiction Agent Renewal Fees
- ◆ Jurisdiction Broker-Dealer Renewal Fees
- ◆ Jurisdiction Investment Adviser Representative Renewal Fees
- ◆ Jurisdiction Investment Adviser Firm Renewal Fees

Final Renewal Statements That Reflect Zero Balances Require No Further Action by the Firm.

On January 3, 2005, all Renewal overpayments were systematically transferred to firms' **Daily** Accounts. All refund requests should be made from that account. If you believe your firm is due a Renewal refund, please check your firm's Daily Account to verify that funds are available. To request a refund check, have an appropriate signatory send a request on firm letterhead to:

NASD
User Support—CRD Accounting
9509 Key West Avenue
Rockville, MD 20850
(301) 869-6699

If the Final Renewal Statement reflects an amount due, NASD should receive Renewal payment no later than February 4, 2005. Firms may submit their payments by:

Electronic Payment via Web CRD/IARD E-Pay

You can access Web CRD/IARD E-Pay at www.nasd.com/crd **OR**

at <https://tradelinks2.mellon.com/cgi-bin/tsmenu.pl/nasd>. There is also a hyperlink to Web CRD/IARD E-Pay on your online Final Renewal Statement.

Check

Make checks payable to NASD and be sure to indicate your firm's CRD Number and the word "Renewals" on the memo line of the check. Print your Final Renewal Statement and mail the first page with your firm's check to:

US MAIL:

NASD, CRD-IARD
P.O. Box 7777-W8705
Philadelphia, PA 19175-8705

(The P.O. Box will **not** accept courier or overnight deliveries.)

EXPRESS DELIVERY:

NASD, CRD-IARD
W8705 c/o Mellon Bank, Rm 3490
701 Market Street
Philadelphia, PA 19106
Phone Number: (301) 869-6699

Please Note that the Renewal Payment addresses noted above are different than the payment addresses for your firm's Daily (Registration) Account.

Wire Transfer

Firms may wire full payment of the Final Renewal Statement by requesting their bank to initiate the wire transfer to: "Mellon Financial in Philadelphia, PA."

You will need to provide your bank the following information:

- ▶ Transfer funds to: **Mellon Financial, Philadelphia, PA**
- ▶ ABA Number: **031 000 037**
- ▶ Beneficiary: **NASD**
- ▶ Account Number: **8-234-353**
- ▶ Reference Number: **Firm CRD Number and the word "Renewals"**

To ensure prompt processing of your Renewal Payment by wire transfer:

- ▶ Remember to inform your bank the funds are to be credited to the NASD Bank Account.
- ▶ Provide your firm's CRD Number and the word "Renewals" as reference only.
- ▶ Record the Confirmation Number of the wire transfer given by your bank.

Transfer Available Funds from Daily Account to Renewal Account

If a firm has sufficient funds in its Daily Account to cover full payment of its Renewal Fees, the firm can contact the Gateway Call Center at (301) 869-6699 or send an e-mail to webcrd@nasd.com, to request a transfer of funds.

Reviewing the Final Renewal Reports

Renewal Reports include all individual registrations renewed for 2005. Registrations that were “pending approval” or were “deficient” at year-end 2004 were not assessed Renewal Fees; therefore, they will not be reported on the **Firm (Agent) Renewal Report**. Firms should examine their report(s) carefully to ensure that all registration approvals and terminations are properly listed. It is also suggested that these reports be made a permanent part of your records. For detailed instructions, please refer to “A Guide to Renewal Reports” in the 2005 NASD Renewal Bulletin. *The Bulletin* can be viewed at www.nasd.com/renewals.

Firm (Agent) Renewal Report—applicable to broker-dealer and investment adviser firms. This report will list all renewed personnel with the NASD, AMEX, CBOE, ISE, NYSE, PCX, PHLX, and/or each jurisdiction. Individuals whose registrations are “approved” with any of these regulators during November and December will be included in this report, while registrations that are still pending approval or are deficient at year’s end will not be included in the 2005 Renewal Program nor will they be listed on the report. If the firm has supplied billing codes, they will be included in this report.

Branches Renewal Report—applicable to NASD members. This report lists each branch registered with NASD and lists branch offices for which the firm is being assessed a fee. Firms should use this report to reconcile their records for Renewal purposes. If a firm finds any discrepancies between its records and those maintained on Web CRD/IARD, the discrepancy must be reported to NASD at the same address used for refund request.

Discrepancies—NASD, AMEX/CBOE/ISE/NYSE/PCX/PHLX/Jurisdictions: All discrepancies should be reported by February 4, 2005. Firms should contact the Gateway Call Center at (301) 869-6699 to report discrepancies. Copies of appropriate documentation, such as Web CRD-generated notice of termination, notification of deficient condition, or notice of approval from the firm’s Firm Queues should be readily available.

The 2005 NASD Renewal Bulletin contains detailed instructions to help firms complete the Renewal Process. This publication can also be found at www.nasd.com/renewals.

©2005. NASD. All rights reserved. *Notices to Members* 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.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Corporate Finance
Legal and Compliance
Operations
Senior Management
Technology
Trading and Market Making
Training

KEY TOPICS

Debt Securities
Dissemination of Transaction
Information
Operations
Rule 6200 Series
TRACE Rules
Transaction Reporting

GUIDANCE

Corporate Debt Securities

Stage Two of the Expansion of Dissemination of TRACE Transaction Data to Begin on February 7, 2005, Instead of February 1, 2005

Executive Summary

NASD is implementing recent amendments to Rule 6250 requiring the immediate or delayed dissemination of information on Trade Reporting and Compliance Engine (TRACE) transactions in two stages (hereinafter, Stage One and Stage Two). The amendments were approved by the Securities and Exchange Commission (SEC) on September 3, 2004, and are described in detail in SR-NASD-2004-094 and *NASD Notice to Members 04-65* (September 2004). The implementation date of Stage One was October 1, 2004. The implementation date of Stage Two, consisting of certain Rule 6250 amendments more fully described below, has been changed from February 1, 2005, to February 7, 2005.¹

Questions/Further Information

Questions concerning this *Notice* should be directed to tracefeedback@nasd.com; Elliot Levine, Chief Counsel, Market Operations, Markets, Services and Information, at (202) 728-8405; or Sharon K. Zackula, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985.

Discussion

NASD is implementing the amendments to Rule 6250 set forth in SR-NASD-2004-094 that require all transactions in TRACE-eligible securities be disseminated on an immediate or delayed basis, except those transactions in TRACE-eligible securities that are issued pursuant to Section 4(2) of the Securities Act of 1933 (Securities Act)

05-02

and purchased or sold pursuant to Rule 144A under the Securities Act.² The SEC approved the amendments to Rule 6250 on September 3, 2004, and NASD implemented certain provisions on October 1, 2004 as Stage One. The remaining provisions were to be implemented on February 1, 2005 as Stage Two.

The implementation date of Stage Two has been changed from February 1, 2005 to February 7, 2005. Generally, in Stage Two, NASD will make effective certain amendments to Rule 6250 that provide for the *delayed dissemination* of information on designated transactions in TRACE-eligible securities. Changing the implementation date will allow NASD to implement Stage Two on a Monday, rather than a Tuesday, which will reduce operational implementation issues.

On February 7, 2005, the following provisions of amended Rule 6250 will become effective, as Stage Two.

- ◆ Rule 6250(a)(1) and (2).
- ◆ The portion of Rule 6250(b)(1)(C)(i) not fully implemented in Stage One: Rule 6250(b)(1)(C)(i) was not fully implemented in Stage One in that transactions of \$1 million or less (par value) in any TRACE-eligible security described in Rule 6250(b)(1)(C)(i) *that did not meet or exceed the frequency standard in Rule 6250(b)(1)(C)(ii)* were not disseminated during Stage One. These transactions will begin to be disseminated on February 7, 2005, the effective date of Stage Two, resulting in the full implementation of Rule 6250(b)(1)(C)(i).
- ◆ Rule 6250(b)(2)(A) and (B).

Each of these provisions is fully described and discussed in SR-NASD-2004-094 and *Notice to Members 04-65* (September 2004).

Endnotes

1 See Securities Exchange Act Release No. _____ (January __, 2005), __ Fed. Reg. _____ (January __, 2005) (File No. SR-NASD-2004-189) (notice of rule change for immediate effectiveness filed on December 28, 2004).

2 See Securities Exchange Act Release No. 50317 (September 3, 2004), 69 FR 55202 (September 13, 2004) (File No. SR-NASD-2004-094) (SEC Approval Order). See also *Notice to Members 04-65* (September 2004).

©2005. NASD. All rights reserved. *Notices to Members* 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.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Legal and Compliance
Operations Managers
Senior Management

KEY TOPICS

Options Exemption
Trading Activity Fee

GUIDANCE

Trading Activity Fee

NASD Provides Updated Options Exemption Listing for the Trading Activity Fee

Discussion

In 2003, the Securities and Exchange Commission (SEC) approved amendments to the NASD By-Laws establishing a Trading Activity Fee (TAF).¹ Among the covered securities excluded from the TAF are transactions in exchange-listed options effected by a member for which NASD is **not** the designated options examining authority (DOEA). Attached is an updated list of broker-dealers, effective January 1, 2005, for which NASD is **not** the DOEA. All member firms, other than those listed in Attachment A, are assessed a TAF on transactions they effect in exchange-listed options. As changes are required, a revised list will be published in a future *Notice to Members*.

Questions/Further Information

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

Endnote

- 1 See SEC Order Approving Proposed Rule Change to Eliminate the Regulatory Fee and Institute a Transaction-Based Trading Activity Fee, Exchange Act Rel. No. 47946 (May 30, 2003), 68 FR 34021 (June 6, 2003) (SR-NASD-2002-148).

©2005. NASD. All rights reserved. *Notices to Members* 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.

2005 DOEA ALLOCATIONS — FIRMS NOT DESIGNATED TO NASD

Firm ID	SEC 8 - #	MPID	Firm Name	City	State
7537	8-21897	ANOS	ABEL NOSER CORP	NEW YORK	NY
15776	8-32746	CHGO	ABN AMRO INCORPORATED	CHICAGO	IL
13071	8-23522	BKBS	ADP CLEARING & OUTSOURCING SERVICES (Fleet securities)	NEW YORK	NY
10	8-21409	ADVS	ADVEST, INC.	HARTFORD	CT
5835	8-16555	BCOM	BAKER & CO., INCORPORATED	CLEVELAND	OH
26091	8-42263	BOFA	BANC OF AMERICA SECURITIES LLC	CHARLOTTE	NC
17066	8-32954	BCHW	BIRCHWOOD SECURITIES CORP.	MEDFORD	NJ
35693	8-46838	ECUT	BNY BROKERAGE INC.	NEW YORK	NY
104487		BBHC	BROWN BROTHERS HARIMAN	NEW YORK	NY
630	8-18333	CIBC	CIBC WORLD MARKETS CORP.	NEW YORK	NY
1588	8-17103	DAVA	DAVENPORT & COMPANY LLC	RICHMOND	VA
115740	8-53521	DOYL	DOYLE MILES & CO	NEW YORK	NY
41957	8-49647	DRKW	DRESDNER KLEINWORT WASSERSTEIN SECURITIES LLC	NEW YORK	NY
25025	8-41354	ETRS	E*TRADE CLEARING LLC	NEW YORK	NY
1781	8-09952	FAGI	FAGENSON & CO., INC.	NEW YORK	NY
7784	8-23292	FIBS	FIDELITY BROKERAGE SERVICES LLC	BOSTON	MA
298	8-02018	FACT	FIRST ALBANY CAPITAL INC.	ALBANY	NY
361	8-00129	GSCO	GOLDMAN, SACHS & CO.	NEW YORK	NY
7536	8-32215	WELC	H. G. WELLINGTON & CO., INC.	NEW YORK	NY
16686	8-34344	GKMC	HARRIS NESBITT GERARD, INC.-	NEW YORK	NY
396	8-17737	HAZL	HAZLETT, BURT & WATSON, INC.	WHEELING	WV
22062	8-39382	BRUS	HD BROUS & CO., INC.	GREAT NECK	NY
867	8-02671	WDSB	HELFANT GROUP, INC. (d/b/a JEFFERSON EXECUTION SERVICES)	NEW YORK	NY
28872	8-43978	INGB	ING FINANCIAL MARKETS	NEW YORK	NY
473	8-17530	JOLE	JOHNSTON, LEMON & CO. INCORPORATED	WASHINGTON	DC

Firm ID	SEC 8 - #	MPID	Firm Name	City	State
7720	8-23135	KBCO	KAHN BROTHERS & CO. INC.	NEW YORK	NY
505	8-17230	LTCO	LADENBURG, THALMANN & CO., INC.	NEW YORK	NY
566	8-30177	MDLD	MCDONALD INVESTMENTS INC.	CLEVELAND	OH
2764	8-28816	MSRO	MESIROW FINANCIAL, INC.	CHICAGO	IL
21520	8-41415	MDWD	MIDWOOD SECURITIES, INC.	NEW YORK	NY
47293	8-51750	MTCO	MILLER TABAK	NEW YORK	NY
4161	8-15001	MOKE	MORGAN KEEGAN & COMPANY, INC.	MEMPHIS	TN
2908	8-01068	NEUB	NEUBERGER BERMAN, LLC	NEW YORK	NY
14020	8-34354	SHMR	O'CONNOR & COMPANY	CHICAGO	IL
7671	8-22871	REND	REYNDERS, GRAY & CO., INCORPORATED	NEW YORK	NY
18377	8-24255	RBLT	ROSENBLATT SECURITIES INC.	NEW YORK	NY
8330	8-24971	SEAP	SEAPORT SECURITIES CORP.	NEW YORK	NY
3403	8-04024	SHRE	SHUFRO, ROSE & CO., LLC	NEW YORK	NY
6220	8-45123	SWST	SOUTHWEST SECURITIES, INC.	DALLAS	TX
3466	8-00526	SILK	SPEAR, LEEDS & KELLOGG, L.P.	NEW YORK	NY
3496	8-01927	SPHN	STEPHENS INC.	LITTLE ROCK	AR
791	8-11754	SALI	STERNE, AGEE & LEACH, INC.	BIRMINGHAM	AL
6670	8-17758	STOX	STOCKCROSS FINANCIAL SERVICES, INC.	BOSTON	MA
5133	8-15656	SPTW	STRASBOURGER PEARSON	NEW YORK	NY
6271	8-17212	STCM	SUNTRUST CAPITAL MARKETS, INC.	ATLANTA	GA
7870	8-23395	WATH	TD WATERHOUSE INVESTOR SERVICES, INC.	NEW YORK	NY
877	8-12987	WEDB	WEDBUSH MORGAN SECURITIES INC.	LOS ANGELES	CA
39310	8-48636	WEXS	WEXFORD CLEARING SERVICES, LLC	NEW YORK	NY
1252	8-02698	WBLR	WILLIAM BLAIR & COMPANY L.L.C.	CHICAGO	IL
8056	8-24126	YOSE	YORK SECURITIES, INC.	NEW YORK	NY

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Executive Representatives
Investment Companies
Legal & Compliance
Mutual Fund
Registered Representatives
Senior Management

KEY TOPICS

Directed Brokerage
Investment Companies
Rule 2830(k)

GUIDANCE

Investment Company Directed Brokerage Arrangements

SEC Approves Amendments to NASD Rule 2830(k) to Strengthen Prohibitions on Investment Company Directed Brokerage Arrangements; **Effective Date: February 14, 2005**

Executive Summary

On December 20, 2004, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 2830(k), which governs NASD members' execution of investment company portfolio transactions.¹ The amended rule augments existing proscriptions on directed brokerage practices by prohibiting a member from selling the shares of, or acting as an underwriter for, any investment company if the member knows or has reason to know that the investment company or its investment adviser or underwriter have directed brokerage arrangements in place that are intended to promote the sale of investment company securities. The amendments also eliminate an existing provision in the rule that permits a member, subject to certain conditions, to sell or underwrite the shares of an investment company that follows a policy of considering fund sales in determining whether to send portfolio transactions to a broker-dealer.

The effective date of this rule change is **February 14, 2005**. Included with this *Notice* is Attachment A (text of rule amendments).

Questions/Further Information

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

05-04

Background and Discussion

NASD Rule 2830(k) generally prohibits NASD members from favoring the sale of shares of any investment company on the basis of brokerage commissions received or expected to be received from any source, including the investment company. Currently, however, Rule 2830(k)(7)(B) permits an NASD member to sell the shares of, or act as an underwriter for, a fund that follows a policy disclosed in its prospectus of considering sales of shares of the fund as a factor in selecting broker-dealers to execute portfolio transactions. A member may sell shares of such an investment company only if the investment company meets the requirements of best execution and the member does not violate any other provision of Rule 2830(k).

The amendments make two principal changes to the rule. First, they eliminate paragraph (k)(7)(B) from the rule. Accordingly, a member may not sell the shares of, or act as an underwriter for, a fund that follows a policy of considering sales of shares of the fund as a factor in selecting broker-dealers to execute portfolio transactions. This rule change is consistent with the SEC's recent amendments to its Rule 12b-1 under the Investment Company Act of 1940, which prohibit funds from compensating a broker-dealer for promoting or selling fund shares by directing brokerage transactions to that broker.²

Second, the amendments add a new paragraph (k)(2) to the rule. This paragraph explicitly states that a member is not permitted to sell shares of, or act as an underwriter for, an investment company that the member knows or has reason to know engages in directing brokerage in consideration for the promotion or sale of shares issued by the investment company or any other registered investment company. Thus, the amended rule would prohibit the sale and distribution of shares of a fund by a member, even where a directed brokerage arrangement is known to exist between the fund and a different broker-dealer.

Note, however, that pursuant to Rule 2830(k)(8)(A), a member that sells shares of an investment company may still execute portfolio transactions of the investment company, provided that the member does not violate any other provision of Rule 2830(k).

These rule changes become effective on **February 14, 2005**.

Endnotes

1 SEC Rel. No. 34-50883 (Dec. 20, 2004), 69 Fed. Reg. 77286 (Dec. 27, 2004).

2 See SEC Rel. No. IC-26591 (Sept. 2, 2004), 69 Fed. Reg. 54727 (Sept. 9, 2004).

©2005. NASD. All rights reserved. *Notices to Members* 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.

ATTACHMENT A

New text is underlined. Deleted text is bracketed.

Text of Rule Change

* * * *

Rule 2830. Investment Company Securities

(a) through (j) No change.

(k) Execution of Investment Company Portfolio Transactions

(1) No member shall, directly or indirectly, favor or disfavor the sale or distribution of shares of any particular investment company or group of investment companies on the basis of brokerage commissions received or expected by such member from any source, including such investment company, or any covered account.

(2) No member shall sell shares of, or act as underwriter for, an investment company, if the member knows or has reason to know that such investment company, or an investment adviser or principal underwriter of the company, has a written or oral agreement or understanding under which the company directs or is expected to direct portfolio securities transactions (or any commission, markup or other remuneration resulting from any such transaction) to a broker or a dealer in consideration for the promotion or sale of shares issued by the company or any other registered investment company.

[(2)] (3) No member shall, directly or indirectly, demand or require brokerage commissions or solicit a promise of such commissions from any source as a condition to the sale or distribution of shares of an investment company.

[(3)] (4) No member shall, directly or indirectly, offer or promise to another member, brokerage commissions from any source as a condition to the sale or distribution of shares of an investment company and no member shall request or arrange for the direction to any member of a specific amount or percentage of brokerage commissions conditioned upon that member's sales or promise of sales of shares of an investment company.

[(4)] (5) No member shall circulate any information regarding the amount or level of brokerage commissions received by the member from any investment company or covered account to other than management personnel who are required, in the overall management of the member's business, to have access to such information.

[(5)] (6) No member shall, with respect to such member's activities as underwriter of investment company shares, suggest, encourage, or sponsor any incentive campaign or special sales effort of another member with respect to the shares of any investment company which incentive or sales effort is, to the knowledge or understanding of such underwriter-member, to be based upon, or financed by, brokerage commissions directed or arranged by the underwriter-member.

[(6)] (7) No member shall, with respect to such member's retail sales or distribution of investment company shares:

(A) provide to salesmen, branch managers or other sales personnel any incentive or additional compensation for the sale of shares of specific investment companies based on the amount of brokerage commissions received or expected from any source, including such investment companies or any covered account. Included in this prohibition are bonuses, preferred compensation lists, sales incentive campaign or contests, or any other method of compensation which provides an incentive to sales personnel to favor or disfavor any investment company or group of investment companies based on brokerage commissions;

(B) recommend specific investment companies to sales personnel, or establish "recommended," "selected," or "preferred" lists of investment companies, regardless of the existence of any special compensation or incentives to favor or disfavor the shares of such company or companies in sales efforts, if such companies are recommended or selected on the basis of brokerage commissions received or expected from any source;

(C) grant to salesmen, branch managers or other sales personnel any participation in brokerage commissions received by such member from portfolio transactions of an investment company whose shares are sold by such member, or from any covered account, if such commissions are directed by, or identified with, such investment company or any covered account; or

(D) use sales of shares of any investment company as a factor in negotiating the price of, or the amount of brokerage commissions to be paid on, a portfolio transaction of an investment company or of any covered account, whether such transaction is executed in the over-the-counter market or elsewhere.

[(7)] (8) Provided that the member does not violate any of the specific provisions of this paragraph (k), nothing herein shall be deemed to prohibit:

(A) the execution of portfolio transactions of any investment company or covered account by members who also sell shares of the investment company; or

[(B)] a member from selling shares of, or acting as underwriter for, an investment company which follows a policy, disclosed in its prospectus, of considering sales of shares of the investment company as a factor in the selection of broker/dealers to execute portfolio transactions, subject to the requirements of best execution;]

[(C)] (B) a member from compensating its salesmen and managers based on total sales of investment company shares attributable to such salesmen or managers, whether by use of overrides, accounting credits, or other compensation methods, provided that such compensation is not designed to favor or disfavor sales of shares of particular investment companies on a basis prohibited by this paragraph (k).

(l) through (n) No change.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Corporate Finance
Legal and Compliance
Operations
Senior Management
Technology
Trading and Market Making
Training

KEY TOPICS

Debt Securities
Dissemination of Transaction
Information
Operations
Rule 6200 Series
TRACE Rules
Transaction Reporting

GUIDANCE

Corporate Debt Securities

NASD Eliminates the TRACE Bond Transaction Data Service (BTDS) Non-Professional Real-Time Data Display Fee and the BTDS Professional Delayed-Time Data Display Fee Pilot Program

Executive Summary

NASD has amended Rule 7010(k) to eliminate the Bond Transaction Data Service (BTDS) Non-Professional Real-Time Data Display Fee, relating to Transaction Reporting and Compliance Engine (TRACE) transaction data, and a second TRACE data fee, the BTDS Professional Delayed-Time Data Display Fee pilot program. Rule 7010(k), as amended, is set forth in Attachment A.

The effective date of the elimination of the BTDS Non-Professional Real-Time Data Display Fee is **February 7, 2005**. The effective date of the termination of the BTDS Professional Delayed-Time Data Display Fee pilot program is **June 1, 2005**.¹

Questions/Further Information

Questions concerning this *Notice* should be directed to tracefeedback@nasd.com; Elliot Levine, Chief Counsel, Market Operations, Markets, Services and Information, at (202) 728-8405; or Sharon K. Zackula, Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8985.

05-05

Discussion

On December 28, 2004, NASD filed a proposed rule change to amend Rule 7010(k) to eliminate two TRACE fees, the BTDS Non-Professional Real-Time Data Display Fee, and the BTDS Professional Delayed-Time Data Display Fee pilot program.²

BTDS Non-Professional Real-Time Data Display Fee

NASD currently charges a minimal fee of \$1.00 per month per terminal for its BTDS Non-Professional Real-Time Data Display service, which allows non-professionals to view TRACE data on a real-time basis. A "non-professional" is defined in Rule 7010(k)(3)(C)(ii) and is limited by definition to natural persons. In addition, the term generally excludes any principal, partner, employee, or other person acting in any capacity in the financial services industry, and any person engaged in or intending to engage in any redistribution of TRACE data.³

NASD will continue to make the TRACE real-time data accessible to non-professionals, but will eliminate the BTDS Non-Professional Real-Time Data Display Fee. NASD is eliminating the fee to remove a financial barrier to the broad-based distribution of TRACE data, particularly to individual investors. Wider distribution of TRACE data is a cornerstone of a broader effort to better educate individual investors about the corporate bond market. NASD anticipates that financial Web sites and other media outlets will be encouraged to redistribute the TRACE market data to individual investors as a result of this fee change. The effective date of the elimination of the BTDS Non-Professional Real-Time Data Display Fee is **February 7, 2005**.

BTDS Professional Delayed-Time Data Display Fee Pilot Program

NASD established a pilot program that charges for TRACE transaction information provided to professionals on a delayed basis. The charge for this pilot program is the BTDS Professional Delayed-Time Data Display Fee of \$15 per month, which is imposed per terminal for each interrogation or display device receiving the delayed data.

As part of a recent comprehensive review of TRACE fees, NASD decided to terminate the BTDS Professional Delayed-Time Data Display Fee and service because the demand for the service was limited. NASD will terminate the pilot program and the related BTDS Professional Delayed-Time Data Display Fee on **June 1, 2005**.

Endnotes

- 1 See Securities Exchange Act Release No. 50977 (January 6, 2005), 70 Fed. Reg. 2202 (January 12, 2005) (File No. SR-NASD-2004-189, filed for immediate effectiveness on December 28, 2004).
- 2 In SR-NASD-2004-189, NASD also proposed to change the implementation date of Stage Two of SR-NASD-2004-094 from February 1, 2005 to February 7, 2005. See *Notice to Members 05-02*.
- 3 Rule 7010(k)(3)(C)(ii) provides:

“Non-Professional” — A non-professional subscriber must provide certain information to NASD and shall receive TRACE market data primarily for his or her personal, noncommercial use. As used in Rule 7010(k)(3) a “non-professional” is a natural person who is neither:

 - a. registered nor qualified in any capacity with the Commission, the Commodity Futures Trading Commission, any state securities agency, any securities exchange or association, or any commodities or futures contract market or association, or an employee of the above who uses such information primarily for business-related activities;
 - b. engaged as an “investment adviser” as that term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (whether or not registered or qualified under that Act), or an employee of the above who uses such information primarily for business-related activities;
 - c. employed by a bank, insurance company or other organization exempt from registration under federal or state securities laws to perform functions that would require registration or qualification if such functions were performed for an organization not so exempt; or
 - d. engaged in, or has the intention to engage in, any redistribution of all or any portion of the information disseminated through TRACE.

©2005. NASD. All rights reserved. *Notices to Members* 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.

ATTACHMENT A

New text is underlined and deleted text is bracketed.

7010. System Services

(a) through (j) No change.

(k) Trade Reporting and Compliance Engine

The following charges shall be paid by participants for the use of the Trade Reporting and Compliance Engine ("TRACE"):

System Fees	Transaction Reporting Fees	Market Data Fees
Level I Trade Report Only Web Browser Access - \$20/month per user ID Level II Full Service Web Browser Access - \$80/month per user ID	Trades up to and including \$200,000 par value - \$0.475/trade; Trades between \$201,000 and \$999,999 par value - \$0.002375 times the number of bonds traded/trade; Trades of \$1,000,000 par value or more - \$2.375/trade	BTDS Professional Real-Time Data Display - \$60/month per terminal, except
CTCI/Third Party - \$25/month/ per firm	Cancel/Correct - \$1.50/trade	[BTDS Professional Delayed-Time Data Display - \$15/month per terminal]
	"As of" Trade Late - \$3/trade	BTDS Internal Usage Authorization \$500/month per application/ service for Real-Time and Delayed-Time Data
		BTDS External Usage Authorization \$1,000/month per application/ service for Real-Time and Delayed-Time Data
		BTDS Non-Professional Real-Time Data Display – <u>No charge</u> [\$1/month per terminal]

(1) through (2) No change.

(3) Market Data Fees

Professionals and non-professionals may subscribe to receive Real-Time and Delayed-Time TRACE data disseminated by NASD in one or more of the following ways for the charges specified, as applicable.

Members,

vendors and other redistributors shall be required to execute appropriate agreements with NASD.

(A) Professional Fees

Professionals may subscribe for the following:

(i) No change.

(ii) Reserved. [For a pilot period commencing February 1, 2004, and lasting through July 31, 2005, BTDS Professional Delayed-Time Data Display Fee of \$15 per month, per terminal charge for each interrogation or display device receiving Delayed-Time TRACE transaction data; provided, that subscribers to the BTDS Professional Real-Time Data Display Fee described above shall not be charged this additional fee. Subject to the execution of appropriate agreements with NASD, certain summary market information of Delayed-Time TRACE transaction data may be published or distributed by newspapers, press associations, newsletters, or similar media sources without charge.]

(iii) through (iv) No change.

(B) Non-Professional Fees

[The charge to be] There shall be no charge paid by a non-professional for [each terminal]receiving all or any portion of Real-Time TRACE transaction data disseminated through TRACE_] shall be \$1.00 per month, per terminal.]

(C) through (D) No change.

(l) through (u) No change.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Institutional
Legal & Compliance
Options
Senior management
Trading
Training

KEY TOPICS

Delta Hedging
Exercise Limits
Hedge Exemption
Options
OTC Derivatives Dealers
Position Limits
Rule 2860

GUIDANCE

Options Position and Exercise Limits

Exemption for Delta Neutral Positions of OTC Derivatives Dealers; **Effective Date: February 28, 2005**

Executive Summary

On November 29, 2004, the Securities and Exchange Commission (SEC) approved amendments to NASD's rules governing stock options position and exercise limits for stock options positions held by an OTC Derivatives Dealer affiliated with an NASD member firm when the position is "delta neutral."¹ Under the amended rule, a stock options position of an OTC Derivatives Dealer that is "delta neutral" is exempt from position and exercise limits if certain conditions are satisfied. Stock options positions of an OTC Derivatives Dealer that are not delta neutral remain subject to position and exercise limits.

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

The amendments are effective on **February 28, 2005**.

Questions/Further Information

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

Background and Discussion

NASD Rule 2860(b)(3)(A) provides, among other things, that no NASD member shall effect, for any account in which such member has an interest, or for the account of any partner, officer, director, or employee thereof, or for the account of any customer, non-member broker, or non-member dealer, an opening transaction in a stock options contract of any class of stock options if the member has reason to believe that such transaction would result in the account holder, acting alone or in concert with others, directly or indirectly, holding or controlling or being obligated in respect of an aggregate equity options position in excess of specified base limits. The Rule also contains an equity options hedge exemption to allow certain hedged positions in excess of the base limits.

While in recent years NASD has increased in absolute terms the size of its options position and exercise limits as well as the size and scope of available exemptions for hedged positions,² these increases have generally required a one-to-one hedge (e.g., one stock options contract must be hedged by one hundred shares of stock). In practice, however, many firms and customers do not hedge their options positions in this way. Rather, firms typically engage in what is known as “delta hedging,” which varies the number of shares of stock used to hedge an options position based upon the relative sensitivity of the value of the options contract to a change in the price of the underlying stock.³ Delta hedging is a widely accepted risk management tool.

In 1998, the SEC approved rules allowing U.S. securities firms to establish a separately capitalized entity to engage in dealer activities in eligible OTC derivative instruments.⁴ This separately capitalized entity, known as an OTC Derivatives Dealer, receives preferential capital treatment and is not required to be a member of an SRO. In general, most transactions of an OTC Derivatives Dealer (including stock options transactions) must be effected through its fully regulated broker-dealer affiliate, except to the extent otherwise permitted by Rule 15a-1 under the Exchange Act. If the fully regulated broker-dealer affiliate effecting the transaction between the OTC Derivatives Dealer and its counterparty is an NASD member, NASD’s stock options position and exercise limits continue to apply to the transaction.

The SEC recognized that the application of position and exercise limits could deter parties from entering into transactions they otherwise would seek to conduct with an OTC Derivatives Dealer in the absence of such limits.⁵ At the time it approved its rules establishing the framework for OTC Derivatives Dealers, the SEC specifically encouraged NASD to revise its rules to recognize as “hedged” those options positions of an OTC Derivatives Dealer that are hedged on a “delta neutral basis” (*i.e.*, the position is delta neutral or fully hedged with regard to the risk that the price of the stock underlying the options position might change).⁶

The amendments to Rule 2860 fulfill the SEC's request. Under the new provisions in Rule 2860(b)(3)(A)(vii), delta neutral stock options positions of an OTC Derivatives Dealer will be exempt from Rule 2860 if certain conditions are satisfied. The term delta neutral is defined in subparagraph (b)(2)(R) and "describes a stock options position that has been hedged, in accordance with an SEC-approved pricing model, with a portfolio of instruments relating to the same underlying stock to offset the risk that the value of the options position will change with changes in the price of the stock underlying the options position." The new exemption from position and exercise limits for stock options positions that are delta neutral applies only to positions of an OTC Derivatives Dealer; stock options position limits for other persons are unchanged.

The first condition, in subparagraph (b)(3)(A)(vii)b.1, is that a member must receive a written representation from its affiliated OTC Derivatives Dealer stating that the OTC Derivatives Dealer is hedging its stock options positions in accordance with its internal risk management control systems and pricing models approved by the SEC. This written representation will enable NASD to determine when a firm is relying on the delta hedging exemption on behalf of its OTC Derivatives Dealer affiliate. This written representation is not required to be filed with NASD, but must be maintained in accordance with the SEC's and NASD's recordkeeping requirements.

The second condition, in subparagraph (b)(3)(A)(vii)b.2, is that the member must continue to report stock options positions of the OTC Derivatives Dealer, including those that are delta neutral, in accordance with NASD Rule 2860(b)(5). These reports will inform NASD of the OTC Derivatives Dealer's aggregate stock options positions and permit NASD to conduct surveillance for market manipulation, insider trading, and other trading abuses. These position reports must be filed in electronic form with NASD's Market Regulation Department. More detailed information about electronic filing of options positions will be provided in a forthcoming *Notice*.

The third condition, in subparagraph (b)(3)(A)(vii)b.3, is that any stock options position that is not delta neutral must remain subject to position and, by extension, exercise limits (subject, however, to the availability of any other exemptions). An OTC Derivatives Dealer generally employs delta hedging as part of its risk management program, but it is nevertheless possible that an OTC Derivatives Dealer may maintain certain positions that are not fully hedged, so long as the entity as a whole meets the conditions imposed by the SEC. In such cases, only the options contract equivalent of the "net delta" of any such stock options positions, which is the net delta divided by 100, would be subject to position limits. The "net delta" is defined in subparagraph (b)(2)(HH) to mean "the number of shares that must be maintained (either long or short) to offset the risk that the value of a stock options position will change with changes in the price of the stock underlying the options position."

This calculation of an options contract equivalent conforms to former Rule 2860(b)(2)(JJ) (now subparagraph (LL) with this rule amendment), which provides that, for purposes of subparagraphs (3) through (12) of Rule 2860(b), a stock option overlying other than 100 shares “shall be deemed to constitute as many options contracts as that other number of shares divided by 100 (e.g., an option to buy or sell five hundred shares of common stocks shall be considered as five options contracts).”

Importantly, the SEC noted that while Rule 2860(b)(3)(A)(vii) provides for multiple, independent hedge exemptions, to the extent that a position is used to hedge for the purpose of one exemption from position limit requirements, such as the delta hedge exemption, that position could not then be used to take advantage of another exemption from position limit requirements.⁷ Finally, members should be aware that, for purposes of the OTC Derivatives Dealer exemption, only financial instruments relating to the stock underlying a stock options position may be included in any determination of a stock options position’s net delta or whether the stock options position is delta neutral.⁸

Endnotes

- 1 Securities Exchange Act Release No. 50748 (Nov. 29, 2004); 69 FR 70485 (Dec. 6, 2004) (SR-NASD-2004-153). As discussed in this *Notice*, the term “delta neutral” is defined in amended Rule 2860(b)(2)(R).
- 2 See Securities Exchange Act Rel. No. 47307 (Feb. 3, 2003), 68 FR 6977 (Feb. 11, 2003) (SR-NASD-2002-134); Securities Exchange Act Rel. No. 40932 (Jan. 11, 1999), 64 FR 2930 (Jan. 19, 1999) (SR-NASD-98-92); Securities Exchange Act Rel. No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998) (SR-NASD-98-23); Securities Exchange Act Rel. No. 39771 (Mar. 19, 1998), 63 FR 14743 (Mar. 26, 1998) (SR-NASD-98-15).
- 3 For example, an option with a delta of .5 will move \$0.50 for every \$1.00 move in the underlying stock.
- 4 Securities Exchange Act Rel. No. 40594 (Oct. 23, 1998), 63 FR 59361 (Nov. 3, 1998) (SEC File No. S7-30-97).
- 5 *Id.* at 59380.
- 6 *Id.*
- 7 69 FR 704865.
- 8 For example, for purposes of the OTC Derivatives Dealer exemption, warrants granting the right to purchase, or convertible bonds that may be converted into, ABC stock might be used to offset the risk associated with a position in ABC puts granting the holder the right to sell ABC stock because the warrants and convertible bonds relate to ABC stock. However, for purposes of the exemption, a position in ABC calls granting the holder the right to purchase ABC stock may not be hedged by puts (or any other financial instrument) overlying any security *other than* ABC stock. That is, a stock options position may be hedged with a financial product other than a stock option, but that financial product must overlie or otherwise be related to the same stock underlying the stock options position being hedged.

©2005. NASD. All rights reserved. *Notices to Members* 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.

ATTACHMENT A

New language is underlined; deletions are in brackets.

2800. SPECIAL PRODUCTS

2860. Options

(a) No Change.

(b) Requirements

(1) No Change.

(2) Definitions

(A) through (Q) No Change.

(R) Delta Neutral—The term “delta neutral” describes a stock options position that has been hedged, in accordance with an SEC-approved pricing model, with a portfolio of instruments relating to the same underlying stock to offset the risk that the value of the options position will change with changes in the price of the stock underlying the options position.

Current (R) through (FF) Renumbered as (S) through (GG).

(HH) Net Delta—The term “net delta” means the number of shares that must be maintained (either long or short) to offset the risk that the value of a stock options position will change with changes in the price of the stock underlying the options position.

Current (GG) through (BBB) Renumbered as (II) through (DDD).

(3) Position Limits

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

aggregate equity options position in excess of:

(i) through (vi) No Change.

(vii) Equity Options Hedge Exemptions

a. No Change.

b. Delta Hedging Exemption for OTC Derivatives Dealer A stock options position of an OTC Derivatives Dealer (as that term is defined in Rule 3b-12 under the Act) affiliated with a member, in standardized or conventional options that is delta neutral, shall be exempt from position limits under this rule if the following conditions are satisfied:

1. The member has obtained a written representation from its affiliated OTC Derivatives Dealer that such entity is hedging its stock options positions in accordance with its internal risk management control systems and pricing models approved by the SEC pursuant to Rules 15c3-1(a)(5) and 15c3-1f under the Act, and that if it ceases to hedge stock options positions in accordance with such systems and models, that it will provide immediate written notice to the member.

2. The member must report in accordance with paragraph (b)(5), all stock options positions (including those that are delta neutral) of 200 or more contracts (whether long or short) on the same side of the market covering the same underlying stock that are effected by the member.

3. Any stock options position of an OTC Derivatives Dealer that is not delta neutral shall be subject to position limits in accordance with this section (subject, however, to the availability of other exemptions). For these purposes, only the option contract equivalent of the net delta of such positions is subject to position limits. The options contract equivalent of the net delta is the net delta divided by 100.

(viii) No Change.

(B) through (D) No Change.

(4) through (24) No Change.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Senior Management
Training

KEY TOPICS

Cold Call
Do-Not-Call
Do-Not-Call Registry
Rule 2212
Telemarketing
Telephone Solicitation

GUIDANCE

Do-Not-Call Registry

SEC Approves Amendments to Rule 2212 Concerning Frequency of Updates From the National Do-Not-Call Registry; **Effective Date: March 1, 2005**

Executive Summary

On January 11, 2005, the Securities and Exchange Commission (SEC) approved amendments to NASD Rule 2212, NASD's telemarketing sales rule.¹ A member that seeks to qualify for the safe harbor set forth in Rule 2212 now will be required to, among other things, use a process to prevent telephone solicitations to any telephone number in a version of the national do-not-call registry obtained from the administrator of the registry no more than **thirty-one (31) days** prior to the date any call is made. This amendment is consistent with recent amendments to the comparable do-not-call rules of the Federal Trade Commission (FTC) and the Federal Communications Commission (FCC).

The amendment becomes effective on **March 1, 2005**.

The rule, as amended, is set forth in Attachment A.

Questions/Further Information

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

Background and Discussion

In 2003, the FTC and FCC established requirements for sellers and telemarketers to participate in a national do-not-call registry. Since June 2003, consumers have been able to enter their home telephone numbers into the national do-not-call registry, which is maintained by the FTC. Under rules of the FTC and FCC, sellers and telemarketers generally are prohibited from making telephone solicitations to consumers whose numbers are listed in the national do-not-call registry.

In July 2003, the SEC requested that NASD amend its telemarketing rules to require NASD members to participate in the national do-not-call registry. The SEC approved NASD's amended rules in January 2004, and the rules took effect on March 31, 2004.²

Safe Harbor Provision for the National Do-Not-Call Registry Requirements

The FCC and FTC each provided persons subject to their respective do-not-call rules a "safe harbor" providing that a seller or telemarketer is not liable for a violation of the do-not-call rules that is the result of an error if the seller or telemarketer's routine business practice meets certain specified standards. NASD has provided a parallel safe harbor in paragraph (c) of Rule 2212. This safe harbor is limited to a violation of subparagraph (a)(3) of Rule 2212, which prohibits initiating any telephone solicitation to any person who has registered his or her phone number with the national do-not-call registry.

To be eligible for the safe harbor in Rule 2212, a member or person associated with a member must demonstrate that the member's routine business practice meets four standards. The first three of these four standards remain unchanged, and the fourth standard is modified as described below. First, the member must have established and implemented written procedures to comply with the national do-not-call rules. Second, the member must have trained its personnel, and any entity assisting it in its compliance, in procedures established pursuant to the national do-not-call rules. Third, the member must have maintained and recorded a list of telephone numbers that the member may not contact. Fourth, a member must use a process to prevent telephone solicitations to any telephone number on any list established pursuant to the do-not-call rules, employing a version of the national do-not-call registry obtained from the FTC no more than three months prior to the date any call is made, and must maintain records documenting this process. This fourth standard has now changed.

Shortly after NASD's rules were approved, Congress instructed the FTC to amend its telemarketing rules to require use of the national do-not-call registry no more than thirty-one (31) days old – as opposed to three months – before a telephone solicitation call is made.³ Accordingly, in March 2004, the FTC amended its Telemarketing Sales Rule to require sellers and telemarketers seeking to qualify for the FTC's do-not-call safe harbor to use a version of the national do-not-call registry obtained from the FTC no more than thirty-one (31) days prior to the date any telephone solicitation call is made. In August 2004, the FCC adopted a conforming amendment to its Miscellaneous Rules Relating to Common Carriers, requiring that persons who seek to qualify for a similar safe harbor provided in the rule use a version of the national do-not-call registry obtained from the administrator of the national do-not-call registry (*i.e.*, the FTC) no more than thirty-one (31) days prior to the date any telephone solicitation call is made.⁴ The FTC and FCC rule amendments took effect on January 1, 2005.

NASD has amended Rule 2212 to conform to the changes in the rules of the FTC and FCC. Effective March 1, 2005, under amended Rule 2212(c)(4), a member relying on Rule 2212's safe harbor provision must use a process to prevent telephone solicitations to any telephone number on any list established pursuant to the do-not-call rules, employing a version of the national do-not-call registry obtained from the administrator of the registry no more than **thirty-one (31) days** prior to the date any call is made, and must maintain records documenting this process.

Endnotes

- 1 See SEC Notice and Accelerated Approval of Rule Change Relating to Frequency of Updates From the National Do-Not-Call Registry, Exchange Act Release No. 51023 (Jan. 11, 2005), 70 Fed. Reg. 3083 (Jan. 19, 2005) (File No. SR-NASD-2004-174).
- 2 SEC Notice and Accelerated Approval of Proposed Amendments to NASD's Telemarketing Rules to Require Members To Participate in the National Do-Not-Call Registry, Exchange Act Rel. No. 49055 (Jan. 12, 2004); 69 Fed. Reg. 2801 (Jan. 20, 2004) (File No. SR-NASD-2003-131). See also NASD *Notice to Members 04-15* for detailed background relating to NASD's rule amendments relating to the establishment of the national do-not-call registry.
- 3 FCC Statement of Basis and Purpose and final amended Telemarketing Sales Rule, 69 Fed. Reg. 16368 (Mar. 29, 2004). The FTC indicated that it was directed to amend its rules by Congress in the Consolidated Appropriations Act of 2004, Public Law 108-199, 188 Stat 3 (requirement in Division B, Title V).
- 4 Final FCC Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991, 69 Fed. Reg. 60311 (Oct. 8, 2004); CG Docket No. 02-278, FCC 04-204 (adopted Aug. 25, 2004; released Sept. 21, 2004). The FCC indicated that while Congress did not direct the FCC to amend its do-not-call rule, it determined to do so, in part, because it is required to consult and coordinate with the FTC with respect to, and maximize the consistency of, their respective do-not-call rules. 69 Fed. Reg. 60313.

©2005. NASD. All rights reserved. *Notices to Members* 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.

ATTACHMENT A

New language is underlined; deleted language is in brackets.

2200. COMMUNICATIONS WITH CUSTOMERS AND THE PUBLIC

* * * * *

2212. Telemarketing

(a) No Change.

(b) No Change.

(c) Safe Harbor Provision

(1) - (3) No Change.

(4) Accessing the national do-not-call database. The member uses a process to prevent telephone solicitations to any telephone number on any list established pursuant to the do-not-call rules, employing a version of the national do-not-call registry obtained from the administrator of the registry no more than [three months] thirty-one (31) days prior to the date any call is made, and maintains records documenting this process.

(d) - (g) No Change.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Legal & Compliance
Operations
Registered Representatives
Senior Management
Trading

KEY TOPICS

Account Name/Designation Changes
Institutional Securities Activities
Rule 3012 (Supervisory Control Systems)
Rule 3110 (Books and Records)
Supervision
Supervisory Control Procedures

GUIDANCE

Supervisory Controls

Guidance Regarding the Application of the Supervisory Control Amendments to Members' Securities Activities, Including Members' Institutional Securities Activities

Executive Summary

On September 30, 2004, the Securities and Exchange Commission (SEC) approved the Supervisory Control Amendments in their final form.¹ Previously, on June 17, 2004, the SEC approved similar rule changes proposed by the New York Stock Exchange (NYSE) to enhance its members' supervisory and supervisory control systems (Internal Control Amendments).² NASD's Supervisory Control Amendments and the NYSE's Internal Control Amendments become effective on January 31, 2005. Although NASD and the NYSE (the SROs) have previously provided their respective members with general guidance regarding the application of the new rule changes,³ additional questions have been raised. Accordingly, the SROs are issuing this joint memorandum to address those issues. The joint memorandum is set forth in Attachment A. The relevant NASD rule text is set forth in Attachment B.

Questions/Further Information

Questions or comments concerning this *Notice* may be directed to Patricia Albrecht, Assistant General Counsel, Office of General Counsel, Regulatory Policy and Oversight, at (202) 728-8026.

05-08

Endnotes

- 1 Exchange Act Release No. 50477 (September 30, 2004), 69 F.R. 59972 (October 6, 2004) (SR-NASD-2004-116).
- 2 Exchange Act Release No. 49882 (June 17, 2004), 69 F.R. 35108 (June 23, 2004).
- 3 See *NYSE Information Memo 04-38* (July 25, 2004); *NASD Notice to Members 04-71* (October 2004). See also NASD Supervisory Control Amendments Phone-In Workshop Transcript (December 16, 2004), which is available on the NASD Web site at: www.nasd.com/web/groups/educ_progs/documents/education_phone_workshop/nasdw_012809.pdf.

©2005. NASD. All rights reserved. *Notices to Members* 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.

ATTACHMENT A

JOINT MEMORANDUM OF NASD AND THE NYSE

Background

Adequate supervisory systems play an important role in assuring investor protection and the integrity of the securities markets. Operational and sales practice abuses can stem from ineffective supervisory systems and supervisory control procedures. Several recent broker misappropriation cases have brought heightened attention to the potential for operational and sales practice abuses at firms, and to the corresponding need to ensure that firms effectively monitor the activities of their employees.

In light of these concerns, NASD and the NYSE proposed new rules and rule amendments intended to strengthen their memberships' supervisory systems. On June 17, 2004, the SEC approved the NYSE's proposed rule amendments;¹ the NASD's corresponding rule amendments were approved in final form on September 30, 2004.² The amendments become effective on January 31, 2005.

Although NASD and the NYSE have previously provided their respective members and member organizations with general guidance regarding the application of the new rule changes,³ additional issues have been raised that require further clarification. The following questions and answers address those issues.

NYSE Internal Control and NASD Supervisory Control Amendments – Joint Questions and Answers

Producing Managers – NYSE Rule 342.19 and NASD Rule 3012

1. Who is considered a “Producing Manager” for purposes of NYSE Rule 342.19 and NASD Rule 3012?

In general, a Producing Manager is a branch office manager, a sales manager, a regional or district sales manager, or any person who performs a similar supervisory function and who services customer accounts in a capacity requiring registration.

2. Does NYSE Rule 342.19 or NASD Rule 3012 distinguish between a Producing Manager who services retail accounts and a Producing Manager who services only “institutional accounts”?

No. Neither NYSE Rule 342.19 nor NASD Rule 3012 makes such a distinction. While the method of supervisory oversight and review may differ as a matter of firm policy depending on the type of business being conducted, the rules apply to Producing Managers regardless of the nature of the accounts they service.

3. Is there an exception from the requirements of NYSE Rule 342.19 or NASD Rule 3012 for Producing Managers who conduct a limited public business?

No. While the method of supervisory oversight may differ as a matter of firm policy, depending on the level of business being conducted, there is no “de minimis” exception to NYSE Rule 342.19 or NASD Rule 3012 for any person who is deemed a Producing Manager.⁴ For example, if a Branch Office Manager services only a few accounts on behalf of family and friends, that person is still considered to be a Producing Manager for purposes of NYSE Rule 342.19 and NASD Rule 3012.

4. If a registered person occasionally enters orders as an accommodation to a Producing Manager, would the person be subject to the supervision and review requirements prescribed by NYSE Rule 342.19 and NASD Rule 3012?

If a registered person occasionally engages in customer account activity in rare instances solely as an accommodation to a Producing Manager who is out of the office for a short duration (e.g., vacation, travel, illness, etc.), that person would not be deemed to be subject to the supervision and review requirements prescribed by NYSE Rule 342.19 or NASD Rule 3012.

Similarly, if a supervisory person (*i.e.*, a branch office manager, a sales manager, a regional or district sales manager, or any person who performs a similar supervisory function) who does not service customer accounts occasionally enters orders as an accommodation to another registered person who is out of the office for a short duration, the supervisory person would not be subject to the supervision and review requirements prescribed by NYSE Rule 342.19 and NASD Rule 3012.

Whether such status is warranted, however, is a facts and circumstances question to be reasonably determined by the firm. Any sales activity of persons not deemed to be subject to the supervision and review requirements prescribed by Rules 342.19 and 3012 must still be appropriately supervised by another qualified person under the general supervisory requirements of NYSE Rule 342 and NASD Rule 3010.

5. Does customer account activity, as contemplated by NYSE Rule 342.19 and NASD Rule 3012, include stock lending or prime brokerage activity?

No. Neither stock lending activity nor the clearing, financing, or custody functions related to prime brokerage activity, by themselves, are the types of activities at which the rules are directed, though such activities remain subject to the general supervisory requirements of NYSE Rule 342 and NASD Rule 3010.

Application of Alternate Supervision Provision of NYSE Rule 342.19 to a Producing Manager Whose Reviewer Does Not Have a Definitive Link to the Producing Manager's Reviewer

6. NYSE Rule 342.19 requires that if a person designated to review a Producing Manager receives an override or other income derived from that Producing Manager's customer activity that represents more than 10% of the designated person's gross income derived from the member or member organization over the course of a rolling twelve-month period, the member or member organization must establish alternate senior or otherwise independent supervision of that Producing Manager to be conducted by a qualified person pursuant to NYSE Rule 342.13.

If no definitive link can be determined between the compensation of a person designated to supervise a Producing Manager and the Producing Manager's customer activity, is the 10% override provision applicable?

No. The 10% override provision is intended to identify and address arrangements where the independence of a Producing Manager's supervisor may be compromised by a conflict of interest. If no link between the supervisor's salary and the Producing Manager's production exists, there would be no conflict of the kind intended to be addressed by the rule. However, member organizations must use due diligence to determine the existence of any direct or indirect link between the production of Producing Managers and the compensation of their designated supervisors that might give rise to a conflict of interest and trigger the 10% provision.

Dual Members' Compliance with NASD/NYSE Requirements

NASD is clarifying that, in accordance with NASD Rule 3012(b), dual NASD/ NYSE members that comply with NYSE Rule 342.19 and its related interpretations will be considered to be in compliance with Rule 3012, so long as the member also complies with all of the provisions of NYSE Rule 342.19 and applies that rule to all of its securities activities.

Changes in Account Name or Designation – NYSE Rule 410 and NASD Rule 3110(d)

7. Does NYSE Rule 410 or NASD Rule 3110(d) require prior firm approval of all account designation changes?

No. Certain customer-controlled account designation changes would not be subject to the prior approval requirement of NYSE Rule 409 or NASD Rule 3110(d). For example, the following types of changes would not require prior approval by the firm under these rules: (1) allocations from a parent holding account to sub-accounts by an entity registered under Section 8 of the Investment Company Act of 1940; (2) allocations among sub-accounts by investment advisers registered under Section 203 of the Investment Advisers Act of 1940 ("Advisers Act") or registered with the appropriate state authority, as required by Section 203A of the Advisers Act; or (3) allocations in the context of a prime brokerage arrangement.

Customer Notice Under NYSE Rule 401 and NASD Rule 3012(a)(2)

8. Under NYSE Rule 401 and NASD Rule 3012(a)(2), what means would be considered sufficient to demonstrate compliance with the notification requirement?

The rules do not prescribe the means or method of customer notification. However, the rules do require “a means/method of customer confirmation, notification, or follow-up that can be documented.” Accordingly, any customer contact pursuant to this requirement must be memorialized and retained for review. Factors to be considered with respect to the documentation of customer contact would include the date of notification; the means/method of contact (e.g., telephone number, email address, etc.); the account(s) in question; whether there was a response from the customer; and, if so, a brief summary of the customer’s response and any follow-up action taken.

In the case of electronic transactions made by the customer or a customer’s legal representative or agent (e.g., a registered investment adviser or agent acting pursuant to legal written authorization) via secure electronic means that are subject solely to the customer’s control, it would be sufficient under NYSE Rule 401 and NASD Rule 3012 for the system itself, as part of its functions, to generate an electronic notification to the customer evidencing the completed transaction. Whatever the means/method of customer notification used, an informed determination must be made that any persons responsible for following up with a customer be independent of the customer’s registered representative and be subject to appropriate supervision.

9. Are securities transfers that are done through ACATS covered by the “customer notification” requirements of NYSE Rule 401 or NASD Rule 3012(a)(2)?

No. The “customer notification” requirements do not apply to transfers of customer account assets conducted through ACATS; such transfers are governed by NYSE Rule 412 (“Customer Account Transfer Contracts”) and corresponding NASD Rule 11870. However, it is noted that both NYSE Rule 412 and NASD Rule 11870 allow a customer to transfer a portion of his or her account assets outside of ACATS pursuant to “authorized alternate instructions,” such as Letters of Authorization (“LOAs”) transmitted to the carrying (i.e., delivering) organization. Any such “ex-ACATS” transfers are subject to the provisions of NYSE Rule 401 and NASD Rule 3012(a)(2).

Endnotes

- 1 Exchange Act Release No. 49882 (June 17, 2004), 69 F.R. 35108 (June 23, 2004).
- 2 Exchange Act Release No. 50477 (September 30, 2004), 69 F.R. 59972 (October 6, 2004) (SR-NASD-2004-116).
- 3 See *NYSE Information Memo 04-38* (July 25, 2004); *NASD Notice to Members 04-71* (October 2004). See also *NASD Supervisory Control Amendments Phone-In Workshop Transcript* (December 16, 2004), which is available at: www.nasd.com/web/groups/educ_progs/documents/education_phone_workshop/nasdw_012809.pdf.
- 4 See *NASD Notice to Members 04-71* (October 2004).

ATTACHMENT B

Relevant Rule Text

2510. Discretionary Accounts

(a) through (c) No change.

(d) Exceptions

This Rule shall not apply to:

(1) discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a security shall be executed, except that the authority to exercise time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent a specific, written contrary indication signed and dated by the customer. This limitation shall not apply to time and price discretion exercised in an institutional account, as defined in Rule 3110(c)(4), pursuant to valid Good-Till-Cancelled instructions issued on a "not-held" basis. Any exercise of time and price discretion must be reflected on the order ticket;

(2) No Change.

* * * * *

3010. Supervision

(a) Supervisory System

Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules . Final responsibility for proper supervision shall rest with the member. A member's supervisory system shall provide, at a minimum, for the following:

(1) through (7) No change.

(8) Deleted.

(b) No change.

(c) Internal Inspections

(1) Each member shall conduct a review, at least annually, of the businesses in which it engages, which review shall be reasonably designed to assist in detecting and preventing violations of, and achieving compliance with, applicable securities laws and regulations, and with applicable NASD rules. Each member shall review the activities of each office, which shall include the periodic examination of customer accounts to detect and prevent irregularities or abuses.

(A) Each member shall inspect at least annually every office of supervisory jurisdiction and any branch office that supervises one or more non-branch locations.

(B) Each member shall inspect at least every three years every branch office that does not supervise one or more non-branch locations. In establishing how often to inspect each non-supervisory branch office, the firm shall consider whether the nature and complexity of the securities activities for which the location is responsible, the volume of business done, and the number of associated persons assigned to the location require the non-supervisory branch office to be inspected more frequently than every three years. If a member establishes a more frequent inspection cycle, the member must ensure that at least every three years, the inspection requirements enumerated in paragraph (c)(2) have been met. The non-supervisory branch office examination cycle, an explanation of the factors the member used in determining the frequency of the examinations in the cycle, and the manner in which a member will comply with paragraph (c)(2) if using more frequent inspections than every three years shall be set forth in the member's written supervisory and inspection procedures.

(C) Each member shall inspect on a regular periodic schedule every non-branch location. In establishing such schedule, the firm shall consider the nature and complexity of the securities activities for which the location is responsible and the nature and extent of contact with customers. The schedule and an explanation regarding how the member determined the frequency of the examination schedule shall be set forth in the member's written supervisory and inspection procedures.

Each member shall retain a written record of the dates upon which each review and inspection is conducted.

(2) An office inspection and review by a member pursuant to paragraph (c)(1) must be reduced to a written report and kept on file by the member for a minimum of three years, unless the inspection is being conducted pursuant to paragraph (c)(1)(C) and the regular periodic schedule is longer than a three-year cycle, in which case the report must be kept on file at least until the next inspection report has been written. The written inspection report must also include, without limitation, the testing and verification of the member's policies and procedures, including supervisory policies and procedures in the following areas:

-
- (A) Safeguarding of customer funds and securities;
 - (B) Maintaining books and records;
 - (C) Supervision of customer accounts serviced by branch office managers;
 - (D) Transmittal of funds between customers and registered representatives and between customers and third parties;
 - (E) Validation of customer address changes; and
 - (F) Validation of changes in customer account information.

If a member does not engage in all of the activities enumerated above, the member must identify those activities in which it does not engage in the written inspection report and document in the report that supervisory policies and procedures for such activities must be in place before the member can engage in them.

(3) An office inspection by a member pursuant to paragraph (c)(1) may not be conducted by the branch office manager or any person within that office who has supervisory responsibilities or by any individual who is directly or indirectly supervised by such person(s). However, if a member is so limited in size and resources that it cannot comply with this limitation (e.g., a member with only one office or a member has a business model where small or single-person offices report directly to an office of supervisory jurisdiction manager who is also considered the offices' branch office manager), the member may have a principal who has the requisite knowledge to conduct an office inspection perform the inspections. The member, however, must document in the office inspection reports the factors it has relied upon in determining that it is so limited in size and resources that it has no other alternative than to comply in this manner.

A member must have in place procedures that are reasonably designed to provide heightened office inspections if the person conducting the inspection reports to the branch office manager's supervisor or works in an office supervised by the branch manager's supervisor and the branch office manager generates 20% or more of the revenue of the business units supervised by the branch office manager's supervisor. For the purposes of this subsection only, the term "heightened inspection" shall mean those inspection procedures that are designed to avoid conflicts of interest that serve to undermine complete and effective inspection because of the economic, commercial, or financial interests that the branch manager's supervisor holds in the associated persons and businesses being inspected. In addition, for the purpose of this section only, when calculating the 20% threshold, all of the revenue generated by or credited to the branch office or the branch office manager shall be attributed as revenue generated by the business units supervised by the branch office manager's supervisor irrespective of a member's internal allocation of such revenue. A member must calculate the 20% threshold on a rolling, twelve-month basis.

* * * * *

(g) Definitions

(1) No change.

(2)(A) "Branch Office" means any location identified by any means to the public or customers as a location at which the member conducts an investment banking or securities business, excluding:

(i) any location identified in a telephone directory line listing or on a business card or letterhead, which listing, card, or letterhead also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised;

(ii) any location referred to in a member advertisement, as this term is defined in Rule 2210, by its local telephone number and/or local post office box provided that such reference may not contain the address of the non-branch location and, further, that such reference also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch location are directly supervised; or

(iii) any location identified by address in a member's sales literature, as this term is defined in Rule 2210, provided that the sales literature also sets forth the address and telephone number of the branch office or OSJ of the firm from which the person(s) conducting business at the non-branch locations are directly supervised.

(iv) any location where a person conducts business on behalf of the member occasionally and exclusively by appointment for the convenience of customers, so long as each customer is provided with the address and telephone number of the branch office or OSJ of the firm from which the person conducting business at the non-branch location is directly supervised.

(2)(B) Notwithstanding the exclusions provided in paragraph (2)(A), any location that is responsible for supervising the activities of persons associated with the member at one or more non-branch locations of the member is considered to be a branch office.

(3) No change.

3012. Supervisory Control System

(a) General Requirements

(1) Each member shall designate and specifically identify to NASD one or more principals who shall establish, maintain, and enforce a system of supervisory control policies and procedures that (A) test and verify that the member's supervisory procedures are reasonably designed with respect to the activities of the member and its registered representatives and associated persons, to achieve compliance with applicable securities laws and regulations, and with applicable NASD rules and (B) create additional or amend supervisory procedures where the need is identified by such testing and verification. The designated principal or principals must submit to the member's senior management no less than annually, a report detailing each member's system of supervisory controls, the summary of the test results and significant identified exceptions, and any additional or amended supervisory procedures created in response to the test results.

(2) The establishment, maintenance, and enforcement of written supervisory control policies and procedures pursuant to paragraph (a) shall include:

(A) procedures that are reasonably designed to review and supervise the customer account activity conducted by the member's branch office managers, sales managers, regional or district sales managers, or any person performing a similar supervisory function.

(i) A person who is either senior to, or otherwise independent of, the producing manager must perform such supervisory reviews. For purposes of this Rule, an "otherwise independent" person: may not report either directly or indirectly to the producing manager under review; must be situated in an office other than the office of the producing manager; must not otherwise have supervisory responsibility over the activity being reviewed (including not being directly compensated based in whole or in part on the revenues accruing for those activities); and must alternate such review responsibility with another qualified person every two years or less.

(ii) If a member is so limited in size and resources that there is no qualified person senior to, or otherwise independent of, the producing manager to conduct the reviews pursuant to (i) above (e.g., a member has only one office or an insufficient number of qualified personnel who can conduct reviews on a two-year rotation), the reviews may be conducted by a principal who is sufficiently knowledgeable of the member's supervisory control procedures, provided that the reviews are in compliance with (i) to the extent practicable.

(iii) A member relying on (ii) above must document in its supervisory control procedures the factors used to determine that complete compliance with all of the provisions of (i) is not possible and that the required supervisory systems and procedures in place with respect to any producing manager comply with the provisions of (i) above to the extent practicable.

(B) procedures that are reasonably designed to review and monitor the following activities:

(i) all transmittals of funds (e.g., wires or checks, etc.) or securities from customers to third party accounts (i.e., a transmittal that would result in a change of beneficial ownership); from customer accounts to outside entities (e.g., banks, investment companies, etc.); from customer accounts to locations other than a customer's primary residence (e.g., post office box, "in care of" accounts, alternate address, etc.); and between customers and registered representatives, including the hand-delivery of checks;

(ii) customer changes of address and the validation of such changes of address; and

(iii) customer changes of investment objectives and the validation of such changes of investment objectives.

The policies and procedures established pursuant to paragraph (a)(2)(B) must include a means or method of customer confirmation, notification, or follow-up that can be documented. If a member does not engage in all of the activities enumerated above, the member must identify those activities in which it does not engage in its written supervisory control policies and procedures and document in those policies and procedures that additional supervisory policies and procedures for such activities must be in place before the member can engage in them; and

(C) procedures that are reasonably designed to provide heightened supervision over the activities of each producing manager who is responsible for generating 20% or more of the revenue of the business units supervised by the producing manager's supervisor. For the purposes of this subsection only, the term "heightened supervision" shall mean those supervisory procedures that evidence supervisory activities that are designed to avoid conflicts of interest that serve to undermine complete and effective supervision because of the economic, commercial, or financial interests that the supervisor holds in the associated persons and businesses being supervised. In addition, for the purpose of this section only, when calculating the 20% threshold, all of the revenue generated by or credited to the producing manager or the producing manager's office shall be attributed as revenue generated by the business units supervised by the producing manager's supervisor irrespective of a member's internal allocation of such revenue. A member must calculate the 20% threshold on a rolling, twelve-month basis.

(b) Dual Member

Any member in compliance with substantially similar requirements of the New York Stock Exchange, Inc. shall be deemed to be in compliance with the provisions of this Rule.

* * * * *

3110. Books and Records

(a) through (b) No change.

(c) Customer Account Information

(1) through (3) No change.

(4) For purposes of this Rule, Rule 2310, and Rule 2510 the term "institutional account" shall mean the account of:

(A) through (C) No change.

(d) Changes in Account Name or Designation

Before any customer order is executed, there must be placed upon the memorandum for each transaction, the name or designation of the account (or accounts) for which such order is to be executed. No change in such account name(s) (including related accounts) or designation(s) (including error accounts) shall be made unless the change has been authorized by a member or a person(s) designated under the provisions of NASD rules. Such person must, prior to giving his or her approval of the account designation change, be personally informed of the essential facts relative thereto and indicate his or her approval of such change in writing on the order or other similar record of the member. The essential facts relied upon by the person approving the change must be documented in writing and preserved for a period of not less than three years, the first two years in an easily accessible place, as the term "easily accessible place" is used in SEC Rule 17a-4.

For purposes of this paragraph (d), a person(s) designated under the provisions of NASD rules to approve account name or designation changes must pass a qualifying principal examination appropriate to the business of the firm.

* * * * *

IM-3110. Customer Account Information

(a) through (h) No Change.

(i) Holding of Customer Mail

Upon the written instructions of a customer, a member may hold mail for a customer who will not be at his or her usual address for the period of his or her absence, but (A) not to exceed two months if the member is advised that such customer will be on vacation or traveling or (B) not to exceed three months if the customer is going abroad.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Legal & Compliance
Senior Management

KEY TOPICS

Arbitration
Books and Records
Predispute Arbitration Agreements

GUIDANCE

Predispute Arbitration Agreements

NASD Amends Rule Governing Predispute Arbitration Agreements with Customers; **Effective Date: May 1, 2005**

Executive Summary

The Securities and Exchange Commission (SEC) has approved amendments to NASD Rule 3110(f) that require firms to modify their predispute arbitration agreements with customers to provide enhanced disclosure about the arbitration process.¹ The amendments also: require members to provide copies of predispute arbitration agreements and relevant arbitration forum rules to customers upon request; clarify the use of certain limiting provisions; and require firms seeking to compel arbitration of claims initiated in court to arbitrate all of the claims contained in the complaint if the customer so requests. Rule 3110(f), as amended, is attached as Attachment A.

The effective date of this rule change is **May 1, 2005**. Predispute arbitration agreements will be governed by the version of Rule 3110(f) in effect at the time the agreement was executed, except that Rule 3110(f)(3) as amended applies to all new and existing agreements.

Questions/Further Information

Questions regarding this *Notice* can be directed to Laura Gansler, Assistant General Counsel, Regulatory Policy and Oversight, at (202) 728-8275 or laura.gansler@nasd.com; or Jean I. Feeney, Vice President and Chief Counsel, Dispute Resolution, at (202) 728-6959 or jean.feeney@nasd.com.

05-09

Background and Discussion

Many broker-dealers require that customers seeking to open accounts, particularly margin and option accounts or accounts with a checking or money market feature, agree in writing to arbitrate disputes concerning the account, typically in a forum sponsored by a self-regulatory organization (SRO). To ensure that customers are advised about what they are agreeing to when they sign predispute arbitration agreements, NASD Rule 3110(f)(1) requires that such agreements contain highlighted disclosure about the differences between arbitration and litigation, including notice that by agreeing to arbitrate their disputes, customers may be waiving certain rights that would be available in court.

Despite these precautions, investor groups have expressed concern that the current disclosure is inadequate, and is not written in plain English. To address these concerns, NASD has amended Rule 3110(f)(1) to make the required disclosure easier to understand, and to include new disclosure that the rules of some arbitration forums may impose time limits for bringing claims in arbitration, and that, in some cases, claims that are ineligible for arbitration may be brought in court. The amendment also requires that the agreement clearly state that the parties agree that the rules of the arbitration forum in which a claim is brought, and any amendments thereto, are incorporated into the parties' agreement. This provision is intended to ensure that the rules of a forum apply to cases brought in that forum and eliminate the need to execute new agreements each time a forum changes its rules. Accordingly, if a customer files a complaint in the NASD arbitration forum, NASD's arbitration rules would apply in all respects to the agreement.

Firms are required to use the new disclosure language in all new customer account agreements containing predispute arbitration agreements as of **May 1, 2005**. The rule change does not require firms to modify or replace existing agreements with current customers. The specific language that must be used, and the manner in which it must be presented, is found in Rule 3110(f)(1)(A)-(G), as amended.

Delivery and Acknowledgment of Predispute Arbitration Clause at Time of Signing

NASD Rule 3110(f)(2) requires that predispute arbitration agreements contain a highlighted statement indicating that the agreement contains an arbitration clause and specifying at what page and paragraph the arbitration clause is located. It also requires that firms provide a copy of the predispute arbitration agreement to the customer, who must in turn acknowledge receipt of the agreement in writing, either on the agreement itself or on a separate document. However, the rule was vague as to when the delivery and acknowledgement must occur. New paragraph (f)(2)(B) of Rule 3110 makes clear that the delivery and customer acknowledgement of the agreement must take place at the time of signing.

New Requirement That Members Provide Copies of Customer Agreements and Information Regarding Arbitration Forums to Customers upon Request

In addition to the delivery requirement at the time of signing, Rule 3110(f)(3) has been amended to require that, within ten days of receiving a customer request, firms must provide the customer with a copy of any predispute arbitration agreement clause or agreement that the customer had signed. NASD has learned that in some instances, firms were refusing to provide copies of agreements to customers who requested them after a dispute arose, making it difficult for customers who had misplaced their original copies to assess their rights and obligations under the agreement. The provision also requires that, if a firm does not have a copy of an agreement requested by a customer, it must inform the customer of that fact. NASD fully expects firms to retain copies of such agreements, as required by NASD rules. However, if for some reason, whether through an act of nature, human error, or otherwise, a member is unable to comply with the customer's request, Rule 3110(f)(3), as amended, requires firms to inform the customer of that fact, rather than simply failing to respond to the customer's request.

Restrictions on Provisions That Limit Rights and Remedies

Rule 3110(f)(4)(A) currently prohibits the use of provisions in predispute arbitration agreements that limit a customer's rights or remedies, or limit the ability of an arbitrator to make an award. To amplify on this provision, the amendments provide that predispute arbitration agreements may not include any condition that would: (i) limit or contradict the rules of any SRO; (ii) limit the ability of a party to file any claim in arbitration; (iii) limit the ability of a party to file any claim in court that could otherwise be filed in court under the rules of the forum(s) in which a claim may be filed under the agreement; or (iv) limit the ability of arbitrators to make any award. These amendments are intended to, among other things, address provisions that attempt to circumvent NASD Rule 10304, governing the eligibility of claims in arbitration.

NASD originally proposed to include a provision explicitly prohibiting the use of arbitrary choice-of-law provisions in predispute arbitration agreements in order to indirectly deprive customers of rights and remedies to which they would otherwise be entitled under applicable state law. However, after reviewing the numerous comments received by the SEC on the proposal, NASD concluded that the proposed provision could be interpreted to undermine protections currently afforded investors under state law. Therefore, NASD withdrew the provision, but reminds firms that, as it has in the past, NASD will continue to interpret Rule 3110(f)(4)(A) to require that, if a choice-of-law provision is used, there must be an adequate nexus between the law chosen and the transaction or parties at issue in accordance with *NASD Notices to Members 95-85* and *95-16*.

Non-Bifurcation Provision

NASD has also amended Rule 3110(f) to require members seeking to compel arbitration of claims filed in court to agree to arbitrate all of the claims contained in the complaint if the customer so requests, even if some of the claims would otherwise be ineligible for arbitration under NASD Rule 10304. The SEC also has approved NASD's proposal to amend Rule 10304 to provide that, by requesting dismissal of a claim on eligibility grounds in the NASD forum, the requesting party is agreeing that the party that filed the dismissed claim may withdraw all related claims without prejudice and may pursue all of the claims in court.² The purpose of these two provisions is to protect investors against involuntary bifurcation of claims.

Effective Date Provisions

The amendments to NASD Rule 3110(f) require various changes to the customer agreements used by NASD member firms. In order to provide enough time for firms to modify customer agreements, the rule change will take effect on **May 1, 2005**, which is 90 days from the date of this *Notice*. The rule change does not require changes to existing agreements. Predispute arbitration agreements will be governed by the version of Rule 3110(f) in effect at the time the agreement was executed, except that Rule 3110(f)(3) as amended applies to all new and existing agreements.

Endnotes

- 1 SEC Rel. No. 34-50713 (Nov. 22, 2004), 69 Fed. Reg. 70293 (Dec. 3, 2004) (SR-NASD-98-74).
- 2 Specifically, NASD has amended Rule 10304 to provide explicitly that arbitrators, rather than the courts, determine the eligibility of claims, and that a party requesting dismissal of a claim on eligibility grounds in NASD's forum agrees that the party that filed the dismissed claim may withdraw all related claims without prejudice and may pursue all of the claims in court. Claims filed in court pursuant to this rule would still be subject to applicable statutes of limitation. See SEC Rel. No. 34-50714 (Nov. 22, 2004), 69 Fed. Reg. 69971 (Dec. 1, 2004) (SR-NASD-2003-101). See also *Notice to Members 05-xx*.

©2005. NASD. All rights reserved. *Notices to Members* 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.

ATTACHMENT A

3000. RESPONSIBILITIES RELATING TO ASSOCIATED PERSONS, EMPLOYEES, AND OTHERS' EMPLOYEES

3110. BOOKS AND RECORDS

(f) Requirements When Using Predispute Arbitration Agreements [With] for Customer Accounts

(1) Any predispute arbitration agreement clause shall be highlighted and shall be immediately preceded by the following [disclosure] language [(printed) in outline form [as set forth herein) which shall also be highlighted]. This agreement contains a predispute arbitration clause. By signing an arbitration agreement the parties agree as follows:

(A) [Arbitration is final and binding on the parties.]All parties to this agreement are giving up the right to sue each other in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.

(B) [The parties are waiving their right to seek remedies in court, including the right to a jury trial.]Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.

(C) [Pre-arbitration discovery is generally more limited than and different from court proceedings.]The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.

(D) [The arbitrators' award is not required to include factual findings or legal reasoning and any party's right to appeal or seek modification of rulings of the arbitrators is strictly limited.]The arbitrators do not have to explain the reason(s) for their award.

(E) The panel of arbitrators will typically include a minority of arbitrators who were or are affiliated with the securities industry.

(F) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.

(G) The rules of the arbitration forum in which the claim is filed, and any amendments thereto, shall be incorporated into this agreement.

(2) (A) [Immediately preceding the signature line,]In any agreement containing a predispute arbitration agreement, there shall be a highlighted statement immediately preceding any signature line or other place for indicating agreement [which shall be highlighted] that states that the agreement contains a predispute arbitration clause. The statement shall also indicate at what page and paragraph the arbitration clause is located.

(B) At the time of signing, a copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.

(3) [A copy of the agreement containing any such clause shall be given to the customer who shall acknowledge receipt thereof on the agreement or on a separate document.]

(A) A member shall provide a customer with a copy of any predispute arbitration clause or customer agreement executed between the customer and the member, or inform the customer that the member does not have a copy thereof, within ten business days of receipt of the customer's request.

(B) Upon request by a customer, a member shall provide the customer with the names of, and information on how to contact or obtain the rules of, all arbitration forums in which a claim may be filed under the agreement.

(4) [No agreement shall include any condition which limits or contradicts the rules of any self-regulatory organization or limits the ability of a party to file any claim in arbitration or limits the ability of the arbitrators to make any award.] No predispute arbitration agreement shall include any condition that:

(i) limits or contradicts the rules of any self-regulatory organization;

(ii) limits the ability of a party to file any claim in arbitration;

(iii) limits the ability of a party to file any claim in court permitted to be filed in court under the rules of the forums in which a claim may be filed under the agreement;

(iv) limits the ability of arbitrators to make any award.

(5) [The requirements of subparagraphs (1) through (4) shall apply only to new agreements signed by an existing or new customer of a member after September 7, 1989.] If a customer files a complaint in court against a member that contains claims that are subject to arbitration pursuant to a predispute arbitration agreement between the member and the customer, the member may seek to compel arbitration of the claims that are subject to arbitration. If the member seeks to compel arbitration of such claims, the member must agree to arbitrate all of the claims contained in the complaint if the customer so requests.

(6) All agreements shall include a statement that “No person shall bring a putative or certified class action to arbitration, nor seek to enforce any predispute arbitration agreement against any person who has initiated in court a putative class action; or who is a member of a putative class action who has not opted out of the class with respect to any claims encompassed by the putative class action until: (i) the class certification is denied; or (ii) the class is decertified; or (iii) the customer is excluded from the class by the court. Such forbearance to enforce an agreement to arbitrate shall not constitute a waiver of any rights under this agreement except to the extent stated herein.”

(7) [The requirements of subparagraph (6) shall apply only to new agreements signed by an existing or new customer of a member after October 28, 1993.]The provisions of this Rule shall become effective on (effective date). The provisions of subparagraph (3) shall apply to all members as of the effective date of this Rule regardless of when the customer agreement in question was executed. Otherwise, agreements signed by a customer before (effective date) are subject to the provisions of this Rule in effect at the time the agreement was signed.

(g) - (h) Unchanged.

Notice to Members

JANUARY 2005

SUGGESTED ROUTING

Legal and Compliance
Senior Management

KEY TOPICS

Arbitration
Dispute Resolution
Eligibility of Arbitration Claims

GUIDANCE

Arbitration Time Limits

NASD Amends Rule Governing Time Limits for Submission of Arbitration Claims; **Effective Date: May 1, 2005**

Executive Summary

The Securities and Exchange Commission (SEC) has approved amendments to Rule 10304 of the NASD Code of Arbitration Procedure (Code) relating to time limits on the submission of claims in arbitration.¹ The amendments clarify that arbitrators, and not courts, will determine whether a claim is ineligible for arbitration under the rule; make clear that dismissal of a claim on eligibility grounds in arbitration does not preclude a claimant from pursuing the claim in court; provide that, by requesting dismissal of a claim under the rule, the requesting party is agreeing that the claimant may withdraw all related claims without prejudice and may pursue all of the claims in court; and state that the six-year time limit on the submission of claims does not apply to any claim that is directed to arbitration by a court of competent jurisdiction upon request of a member or associated person. Rule 10304, as amended, is included in this Notice as Attachment A.

The effective date of this rule change is **May 1, 2005**, for all claims filed with NASD on or after that date.

Questions/Further Information

Questions regarding this *Notice* can be directed to Jean I. Feeney, Vice President and Chief Counsel, Dispute Resolution, at (202) 728-6959 or jean.feeney@nasd.com; or Laura Gansler, Assistant General Counsel, Regulatory Policy and Oversight, at (202) 728-8275 or laura.gansler@nasd.com.

Background and Discussion

Who Makes Eligibility Determinations

Rule 10304 provides that a claim is ineligible for arbitration under the Code if six or more years have elapsed from the occurrence or event giving rise to the claim. Currently, this rule does not state whether the eligibility of a claim is determined by arbitrators or by the courts; however, it is NASD's practice that arbitrators resolve questions concerning whether a particular claim falls within the six-year time limit. The issue of whether arbitrators or courts should determine the eligibility of a claim generated a significant amount of collateral litigation, and was eventually addressed by the United States Supreme Court in December 2002. In *Howsam v. Dean Witter Reynolds, Inc.*,² the Supreme Court determined that the issue of whether a claim is time-barred under Rule 10304 is a matter for arbitrators to decide. Therefore, to provide additional notice and guidance to parties on this issue, NASD is amending Rule 10304 to provide explicitly that the arbitrators make eligibility determinations.

Effect of Arbitrator's Dismissal of Claim as Ineligible

NASD is amending Rule 10304 to clarify that the dismissal of a claim on eligibility grounds does not prohibit a party from pursuing the claim in court. This clarification is necessary because some courts, relying on the "election of remedies" doctrine, have held that claims dismissed as ineligible in arbitration may not be litigated in court. Therefore, Rule 10304 is being amended to state that, under NASD rules, the ineligibility of a claim under Rule 10304 is not intended to prevent a party from filing the claim in court.³

In order to protect parties from having to litigate related claims in two forums at the same time, NASD also is amending Rule 10304 to provide that, by requesting dismissal of a claim on eligibility grounds in the NASD forum, the respondent is agreeing that the claimant may withdraw all related claims without prejudice and may pursue all of the claims in court.⁴ This provision will provide significant protection against involuntary splitting ("bifurcation") of claims, yet continue to allow arbitrators to decide questions of eligibility under Rule 10304.

Applicability of Eligibility Rule to Claims Ordered to Arbitration by Court

NASD is modifying Rule 10304 to provide that the six-year time limit on the submission of claims will not apply to any claim that is directed to arbitration by a court of competent jurisdiction upon request of a member or associated person. Currently, Rule 10304 does not apply to any claims ordered to arbitration by a court. Under the Supreme Court's decision in *Howsam* that eligibility is an issue for the arbitrators, not courts, to resolve, this provision would mean that the eligibility rule could not be applied by either the court or the arbitrators to any claims compelled to arbitration. Under the amendment, however, a member or associated person that compels a claim to arbitration may not then seek to dismiss the claim in arbitration on eligibility grounds. The SEC recently approved a corollary rule filing that amends Rule 3110(f) to require member firms seeking to compel arbitration of claims initiated in court to arbitrate all of the claims contained in the complaint if the customer so requests (regardless of whether such claims would otherwise be time-barred by the eligibility rule).⁵

NASD believes that, by clarifying the scope and application of Rule 10304, the rule amendments will streamline the administration of arbitrations as well as reduce the cost and delay caused by collateral litigation.

Effective Date Provisions

The rule amendments will become effective on **May 1, 2005**. The amendments will apply to claims filed with NASD Dispute Resolution on or after the effective date.

Endnotes

- 1 Exchange Act Rel. No. 50714 (Nov. 22, 2004), 69 Fed. Reg. 69971 (Dec. 1, 2004) (File No. SR-NASD-2003-101).
- 2 537 U.S. 79 (2002).
- 3 The claims would still be subject to applicable statutes of limitations in court.
- 4 See note 3 above.
- 5 *Notice to Members 05-10*; see Exchange Act Rel. No. 50713 (Nov. 22, 2004), 69 Fed. Reg. 70293 (Dec. 3, 2004) (File No. SR-NASD-98-74).

©2005. NASD. All rights reserved. *Notices to Members* 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.

ATTACHMENT A

New text is underlined; deletions are in brackets.

10304. Time Limitation Upon Submission

(a) No dispute, claim, or controversy shall be eligible for submission to arbitration under this Code where six (6) years have elapsed from the occurrence or event giving rise to the act or dispute, claim or controversy. The panel will resolve any questions regarding the eligibility of a claim under this Rule.

(b) Dismissal of a claim under this Rule does not prohibit a party from pursuing the claim in court. By requesting dismissal of a claim under this Rule, the requesting party agrees that if the panel dismisses a claim under the Rule, the party that filed the dismissed claim may withdraw any remaining related claims without prejudice and may pursue all of the claims in court.

(c) This Rule shall not extend applicable statutes of limitations[, nor shall it apply to any case which is directed to arbitration by a court of competent jurisdiction]; nor shall the six-year time limit on the submission of claims apply to any claim that is directed to arbitration by a court of competent jurisdiction upon request of a member or associated person.

Disciplinary and Other NASD Actions

REPORTED FOR JANUARY

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

Firm and Individual Fined

Emmett A. Larkin & Co., Inc. (CRD #6625, San Francisco, California) and Melvin Lee Peterson (CRD #8596900, Registered Principal, Pacifica, California) submitted a Letter of Acceptance, Waiver, and Consent in which they were fined \$32,000, jointly and severally. The firm was also fined an additional \$5,000. Without admitting or denying the allegations, the firm and Peterson consented to the described sanctions and to the entry of findings that the firm, acting through Peterson, failed to file timely disclosures for reportable events to NASD within 10 days and to update promptly Forms U4 (Uniform Application for Securities Industry Registration or Transfer) and U5 (Uniform Termination Notice for Securities Industry Registration) for events requiring regulatory disclosure. The findings also stated that the firm had inadequate written procedures for the firm's supervision relating to the prompt reporting of events requiring regulatory disclosure filings. **(NASD Case #C01040027)**

Firms Fined

Biltmore International Corporation (CRD #21163, Edison, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to accept or decline in the Automated Confirmation Transaction ServiceSM (ACTSM) transactions in eligible securities within 20 minutes after execution that the firm had an obligation to accept or decline in ACT as the order entry identifier (OEID). The findings also stated that the firm failed to follow its written supervisory procedures and thus failed to enforce a supervisory system reasonably designed to achieve compliance with NASD Rule 6130(b). **(NASD Case #CMS040174)**

Buckman, Buckman & Reid, Inc. (CRD #23407, Shrewsbury, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to accept or decline in ACT transactions in eligible securities within 20 minutes after execution that the firm had an obligation to accept or decline in ACT as the Order Entry Firm. **(NASD Case #CMS040187)**

The Camelot Group, Inc. (CRD #31091, Ft. Lauderdale, Florida) was fined \$32,500. The sanction was based on findings that the firm conducted securities business while failing to comply with its minimum net capital requirement and failed to maintain complete, accurate, and current books and records. The findings also stated that the firm materially overstated its net capital in Financial and Operational Combined Uniform Single reports (FOCUS) for four quarters and failed to file its annual audited financial reports in a timely manner for two years. **(NASD Case #C07040051)**

Conners & Co. (CRD #1511, 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 allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report accurately transactions executed, in that trades were reported late and other trades failed to report the correct time of execution, and that the firm failed to report some transactions. NASD also found that the firm failed to establish, maintain, and enforce a supervisory system reasonably designed to enable it to prevent and detect inaccurate reporting of municipal transactions. **(NASD Case #C8A040099)**

Essex Radez LLC (CRD #34649, Chicago, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$27,000, and required to revise the firm's written supervisory procedures with respect to Bid Test, ACT Reporting, and Marking Tickets. Within 30 business days of acceptance of this AWC by the National Adjudicatory Council (NAC), a registered principal of the firm shall submit to NASD a signed, dated letter representing that the firm has revised its written supervisory procedures to address Bid Test, ACT Reporting, and Marking Tickets. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it executed short sale transactions in NASDAQ National Market® (NNM®) securities at or below the current inside bid when the current inside bid was below the preceding inside bid in the security. 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 Bid Test, ACT Reporting, and Marking Tickets. NASD also found that the firm failed, within 90 seconds after execution, to transmit through ACT last sale reports of transactions in NNM securities and failed to designate as ".T" through ACT last sale reports of transactions in NNM securities executed outside normal market hours. **(NASD Case #CMS040178)**

1st Discount Brokerage, Inc. (CRD #39164, West Palm Beach, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$12,500. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of

findings that it failed to monitor reasonably the outside business activities of a registered representative for compliance with NASD Rule 3030. The findings also stated that the registered representative informed the firm he intended to perform clerical, non-investment related services for a company involved in the securities field when, in fact, he circulated misleading, exaggerated, and unwarranted investment opinions and research reports touting Over-the-Counter (OTC) Bulletin Board and Pink Sheet securities that contained unsubstantiated price projections. NASD also found that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning compliance with NASD Conduct Rule 3030. **(NASD Case #CMS040185)**

Fixed Income Securities, LP (CRD #46727, Monument, Colorado) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$80,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report the correct time of execution to the Municipal Securities Rulemaking Board (MSRB) in transactions for which the firm had reporting obligations. The findings further stated that the firm failed to report timely any transaction information for transactions in Trade Reporting and Compliance Engine (TRACE) eligible securities. NASD also found that the firm submitted Wells letters in which the firm provided incomplete or inaccurate information concerning who was responsible for supervision for municipal trade reporting and TRACE reporting, and whether that person met his/her responsibilities. The findings also stated that the firm failed to establish, maintain, and enforce written supervisory procedures reasonably designed to achieve compliance with MSRB Rule G-14 relating to trade reporting in municipal securities and NASD Rule 6230 relating to trade reporting in TRACE-eligible securities. **(NASD Case #CMS040192)**

GVR Company LLC (CRD #111528, Chicago, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$25,000, and required to revise within 30 business days its written supervisory procedures with respect to applicable securities laws, regulations, and NASD rules concerning trade reporting for riskless principal trades, trade reporting for short sales, affirmative determination for proprietary short sales, the Order Audit Trail SystemSM (OATSSM), Securities and Exchange Commission (SEC) Rule 11Ac1-5, and NASD IM-2110-5 (anti-competitive and harassing behavior). Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it transmitted to OATS reports that contained inaccurate, incomplete, or improperly formatted data. The findings also stated that the reports contained inaccurate routed order identifiers and,

therefore, failed to link with reportable order events submitted by an affiliate. Furthermore, NASD found that the firm's supervisory system failed to provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning trade reporting for riskless principal trades, trade reporting for short sales, affirmative determination for proprietary short sales, OATS, SEC Rule 11Ac1-5, and NASD IM-2110-5. (NASD Case #CMS040189)

Investec (US) Incorporated (CRD #266, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanction and to the entry of findings that it accepted customer short sale orders in securities and, for each order, failed to make/annotate an affirmative determination that the firm would receive delivery of the security on behalf of the customer or that the firm could borrow the security on behalf of the customer by the settlement date. The findings also stated that the firm failed to preserve for not less than three years, the first in an accessible place, the memorandum of brokerage orders. (NASD Case #CMS040175)

J.H. Darbie & Co., Inc. (CRD #43520, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$12,500, and required to revise the firm's written supervisory procedures with respect to ACT trade reporting. Within 30 business days of acceptance of this AWC by the NAC, a registered principal of the firm shall submit to NASD a signed, dated letter representing that the firm has revised its written supervisory procedures to address ACT trade reporting. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to accept or decline in ACT transactions in eligible securities within 20 minutes after execution that the firm had an obligation to accept or decline in ACT as the OEID. 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 ACT trade reporting. (NASD Case #CMS040180)

Legg Mason Wood Walker, Inc. (CRD #6555, Baltimore, Maryland) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$10,000, and required to pay \$453.53, plus interest, in restitution to public customers. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that in transactions for or with a public customer, the firm failed to use reasonable diligence to ascertain the best inter-dealer market and failed to buy or sell in such market so that the resultant price to its customer was as favorable as possible under prevailing market conditions. The findings also

stated that the firm failed to execute customer market orders fully and promptly. (NASD Case #CMS040183)

Nomura Securities International, Inc. (CRD #4297, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$12,500, and required to revise the firm's written supervisory procedures with respect to ACT reporting. Within 30 business days of acceptance of this AWC by the NAC, a registered principal of the firm shall submit to NASD a signed, dated letter representing that the firm has revised its written supervisory procedures to address ACT reporting. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report to ACT the correct symbol indicating whether the firm executed transactions in eligible securities in a principal or agency capacity. 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 ACT reporting. (NASD Case #CMS040181)

NT Securities, LLC (CRD #45694, 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 allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report timely to OATS reportable order events (ROEs). The findings also stated that the firm submitted to OATS reports with respect to equity securities traded on The Nasdaq Stock Market, Inc. (NASDAQ) that were not in the electronic form prescribed by NASD and were repairable. The reports were rejected by the OATS system and notice of such rejection was made available to the firm on the OATS Web site, but the firm failed to correct or replace 96 percent of the reports. (NASD Case #CMS040188)

Raymond James Financial Services, Inc. (CRD #6694, St. Petersburg, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$10,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to enforce a supervisory system and written supervisory procedures reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules regarding the formation and maintenance of a partnership with a public customer of the firm. (NASD Case #C8A040107)

Timber Hill LLC (CRD #33319, Greenwich, Connecticut) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured, fined \$25,000, and required to revise the firm's written supervisory procedures regarding the reporting of short sales to ACT. Within 30 business days of

acceptance of this AWC by the NAC, a registered principal of the firm shall submit to NASD a signed, dated letter representing that the firm has revised its written supervisory procedures to address reporting short sales to ACT.

Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report to ACT the correct symbol indicating whether the transaction was a buy, sell, sell short, sell short exempt, or cross for transactions in eligible securities and effected sell orders for securities registered on a national securities exchange without marking each such order "long" or "short." The findings also stated that the firm made available reports on the covered orders in national market systems that it received for execution from any person that inadvertently included incomplete information concerning "Average Realized Spread" and "Average Effective Spread" and a report on the covered orders in national market systems securities that it received for execution from any person that inadvertently included incorrect information concerning "Average Realized Spread" for market orders between 500 and 1,999 shares in a security. NASD also found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules concerning short sales. (NASD Case #CMS040173)

Trident Securities, A Division of McDonald Investments, Inc. (CRD #566, Cleveland, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$15,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to make available, or failed to make available in a timely manner, reports on the covered orders in national market system securities that it received for execution from any person. The findings also stated that the firm failed to make publicly available reports on its routing of non-directed orders in covered securities. NASD also found that the firm's supervisory system did not provide for supervision reasonably designed to achieve compliance with SEC Rules 11Ac1-5 and 11Ac1-6. (NASD Case #CMS040184)

W. R. Hambrecht & Co., L.L.C. (CRD #45040, San Francisco, California) submitted a Letter of Acceptance, Waiver, and Consent in which the firm was censured and fined \$20,000. Without admitting or denying the allegations, the firm consented to the described sanctions and to the entry of findings that it failed to report correctly to ACT the transaction type for transactions that were reported as cross transactions when they were, in fact, riskless principal transactions; failed to prepare and retain an order ticket for one side of the trade in trades effected on a riskless principal basis; and failed to indicate the time of execution on order

tickets in trades effected on a riskless principal basis. The findings also stated that the firm's Anti-Money Laundering (AML) Program was not approved in writing by a member of senior management; failed to identify the internal controls the firm would implement to detect attempts to open correspondent accounts by foreign banks; failed to require the address of U.S. designated agents when opening correspondent accounts for foreign banks; and failed to specify the time frame in which the firm would terminate its relationship with a foreign bank upon notification by the Secretary of Treasury or the Attorney General that the foreign bank had failed to comply with or contest a summons.

NASD also found that the firm's AML Program failed to specify the firm's policy on opening or maintaining private banking accounts for non-U.S. persons and failed to describe the internal controls the firm would implement to detect attempts to open such accounts; failed to have procedures to freeze accounts and prohibit transactions with persons suspected of terrorist activities pursuant to Executive Order #13224 issued by the Office of Foreign Assets Control; and failed to have procedures for providing information to federal law enforcement officers not later than seven days after receipt of a request. (NASD Case #C01040028)

Individuals Barred or Suspended

Thomas Macaulay Babington, Jr. (CRD #2103727, Registered Representative, Palm Bay, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Babington consented to the described sanction and to the entry of findings that he misrepresented the sales charge on a unit investment trust product to public customers and forged their signatures on the transaction cover sheet that would have disclosed the correct sales charge. (NASD Case #C07040095)

Louis Joseph Bacher, Jr. (CRD #1033017, Registered Principal, Benicia, California), Robert Jay Holub (CRD #1321893, Registered Principal, Alamo, California), and Robert Stephen Minka (CRD #1242065, Registered Principal, Vacaville, California) submitted Offers of Settlement in which Bacher and Holub were barred from association with any NASD member in any capacity, and Minka was fined \$10,000 and barred from association with any NASD member in a principal capacity. Without admitting or denying the allegations, Bacher, Holub, and Minka consented to the described sanctions and to the entry of findings that they permitted a statutorily disqualified person to be associated with their member firm. (NASD Case #C01040004)

Inna Basieva a/k/a Inna Tedeev (CRD #4025062, Registered Representative, Brooklyn, New York) submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Basieva consented to the described sanction and to the entry of findings that she arranged for an imposter to take the Series 6 and Series 65 qualification exams on her behalf. **(NASD Case #CLI040034)**

Karl Francis Birkenfeld (CRD #1342720, Registered Representative, Yonkers, New York) submitted an Offer of Settlement in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Birkenfeld consented to the described sanctions and to the entry of findings that he assisted an individual with obtaining a mortgage by falsely representing the individual's employment status and income on documents that comprised a portion of the mortgage application.

Birkenfeld's suspension began December 6, 2004, and concluded at the close of business December 17, 2004. **(NASD Case #C10040021)**

Bryce Allen Boltz (CRD #4569741, Registered Representative, Cuyahoga Falls, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Boltz consented to the described sanction and to the entry of findings that he issued, or caused to be issued, an ATM card for a public customer of his member firm's bank-affiliate without the knowledge or consent of the customer. The findings also stated that Boltz used the card to withdraw funds totaling \$2,700 from the customer's bank account, also without the customer's knowledge or consent. **(NASD Case #C8A040105)**

Tony Ricardo Brown (CRD #2637009, Registered Representative, Chicago, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 10 business days. The fine must be paid before Brown reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Brown consented to the described sanctions and to the entry of findings that he engaged in outside business activities and failed and neglected to provide prompt written notice to his member firm.

Brown's suspension began January 3, 2005, and concluded at the close of business January 14, 2005. **(NASD Case #C8A040100)**

Joseph Charles Broyles (CRD #2834483, Registered Representative, Centereach, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Broyles failed to respond to NASD requests for information. The findings also stated that Broyles effected transactions in the account of a public customer without the customer's knowledge, authorization, or consent. **(NASD Case #CLI040014)**

Lindie Lou Byers (CRD #4492094, Associated Person, Millington, Tennessee) was barred from association with any NASD member in any capacity. The sanction was based on findings that Byers caused checks made payable to various health care providers totaling \$56,078.41 to be issued from a revocable trust account at her member firm without the knowledge or consent of the account trustee or the beneficiary of the trust; deposited the checks into bank accounts she controlled or to which she had access; and withdrew the funds and converted them to her own use and benefit. The findings also stated that Byers failed to respond to NASD requests for information. **(NASD Case #C05040028)**

Daniel Thomas Cella (CRD #2751862, Registered Principal, Valley Cottage, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Cella consented to the described sanction and to the entry of findings that he made inaccurate entries to his member firm's books and records that concealed the existence of approximately \$1,000,000 worth of bonds. **(NASD Case #C9B040097)**

Gerard Robert Celmer (CRD #1779511, Registered Representative, Summit, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Celmer consented to the described sanction and to the entry of findings that he pled guilty in the State of New York to an unclassified misdemeanor charge that he committed securities fraud. **(NASD Case #C10040109)**

Valerie Sue Chandler (CRD #4299431, Registered Representative, Selbyville, Delaware) submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Chandler consented to the described sanction and to the entry of findings that she caused a bank certificate of deposit (CD) owned by a customer of a bank affiliated with her member firm to be redeemed without the customer's knowledge or authorization by forging the customer's signature on a form she completed and used to redeem the CD, thereby converting \$4,987 in cash to her own use and benefit. **(NASD Case #C9A040051)**

Michael Klee Clark (CRD #870083, Registered Representative, Santa Barbara, California) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Clark reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Clark consented to the described sanctions and to the entry of findings that he willfully failed to amend his Form U4 to disclose a material fact.

Clark's suspension began January 3, 2005, and will conclude at the close of business January 2, 2006. **(NASD Case #C02040047)**

Terry Alan Coursey (CRD #1342245, Registered Representative, Burlington, Iowa) submitted an Offer of Settlement in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 60 days. The fine must be paid before Coursey reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Coursey consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Form U4.

Coursey's suspension began January 3, 2005, and will conclude at the close of business March 3, 2005. **(NASD Case #C04040035)**

Wayne Franklin Currie (CRD #3189447, Registered Representative, Marietta, Georgia) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for two months. The fine must be paid before Currie reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Currie consented to the described sanctions and to the entry of findings that he failed to give prompt notice of his outside business activities to his member firm.

Currie's suspension began January 3, 2005, and will conclude at the close of business March 2, 2005. **(NASD Case #C07040093)**

Roger Martin Dail (CRD #3049554, Registered Representative, Brooklyn, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Dail willfully failed to disclose a material fact on his Form U4. **(NASD Case #C10040038)**

Joseph M. DeMercede (CRD #1236793, Registered Representative, Aurora, Illinois) submitted an Offer of Settlement in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before DeMercede reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, DeMercede consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Form U4.

DeMercede's suspension began December 6, 2004, and will conclude March 5, 2005. **(NASD Case #C8A040053)**

Kampta Doobay (CRD #1042985, Registered Representative, New Oakland, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 business days. The fine must be paid before Doobay reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Doobay consented to the described sanctions and to the entry of findings that he circumvented the requirements of New York State Department of Insurance Regulation 60 in connection with the replacement of life insurance policies for public customers. The findings also stated that although Doobay met with each of the customers on two different occasions to discuss the advantages and disadvantages of the replacement products versus the existing products as required by Regulation 60, he backdated replacement documentation for the customers to indicate that all of the documents had been signed by the customers during their initial meetings with Doobay.

Doobay's suspension will begin January 18, 2005, and will conclude at the close of business February 28, 2005. **(NASD Case #CLI040033)**

Taurese L. Edge (CRD #4537340, Registered Representative, Carmel, Indiana) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one year. The fine must be paid before Edge reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Edge consented to the described sanctions and to the entry of findings that he willfully failed to disclose material facts on his Form U4.

Edge's suspension began January 3, 2005, and will conclude at the close of business January 2, 2006. **(NASD Case #C8A040102)**

Masahiko Fukano (CRD #3239348, Registered Principal, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for five months. The fine must be paid before Fukano reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Fukano consented to the described sanctions and to the entry of findings that he guaranteed a public customer against losses in her accounts on several occasions and attempted to settle the customer's complaint concerning losses without informing and obtaining authorization from his member firm.

Fukano's suspension began January 3, 2005, and will conclude at the close of business June 2, 2005. (NASD Case #C10040112)

Fred Granik (CRD #2473748, Registered Representative, Brooklyn, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Granik was authorized to use a corporate credit card by the card's holder to charge airfare and hotel expenses for a business trip but Granik also charged an additional \$727.35 for personal expenses to the card without the individual's authorization and failed to pay the individual for the total amount of \$3,304.07 he charged to the credit card. The findings also stated that Granik willfully failed to disclose material facts on his Form U4. (NASD Case #C9B040050)

Morton Gerald Gropper (CRD #2654159, Registered Representative, New York, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500, suspended from association with any NASD member in any capacity for 30 days, and ordered to pay \$4,520.21, plus interest, in disgorgement of commissions as partial restitution to a public customer. Without admitting or denying the allegations, Gropper consented to the described sanctions and to the entry of findings that he caused to be executed securities transactions in the account of a public customer that were unsuitable based on the customer's financial situation, investment objectives, and needs.

Gropper's suspension began December 6, 2004, and concluded at the close of business January 4, 2005. (NASD Case #C04040053)

Michael John Hanchar (CRD #2051679, Registered Principal, Canon City, Colorado) was barred from association with any NASD member in any capacity. The sanction was based on findings that Hanchar converted \$772,170.82 by unlawfully making redemptions from the mutual fund accounts of public customers, wiring the proceeds to bank accounts of other unrelated shareholders, and subsequently transferring the proceeds to bank accounts

he controlled. The findings also stated that Hanchar failed to respond to NASD requests for information. (NASD Case #C3A040009)

William Franklin Herndon (CRD #1984310, Registered Principal, Wichita, Kansas) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 60 days. Without admitting or denying the allegations, Herndon consented to the described sanctions and to the entry of findings that he engaged in private securities transactions totaling \$112,000 without notifying his member firm of the transactions and his role therein, and without receiving prior written approval from his member firm.

Herndon's suspension will begin January 18, 2005, and will conclude at the close of business March 18, 2005. (NASD Case #C04040057)

Mitchell Hersh (CRD #874733, Registered Representative, Staten Island, New York) submitted an Offer of Settlement in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Hersh consented to the described sanction and to the entry of findings that he knowingly falsified, and/or caused to be falsified, variable annuity policy applications for public customers by recording inaccurate addresses for the customers in order to sell them variable annuity contracts not approved for sale in the states where the customers actually resided. The findings also stated that Hersh knowingly falsified, and/or caused to be falsified, a variable annuity policy application for a customer by recording that the policy application was signed in Florida when, in fact, the application was signed in New York. NASD also found that Hersh knowingly sold variable annuity contracts to public customers that were not approved for sale in the states of the customers' residences. (NASD Case #C10040101)

Antoine J. Hutcheson (CRD #4756526, Associated Person, Metropolis, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for one month. The fine is due and payable before Hutcheson reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Hutcheson consented to the described sanctions and to the entry of findings that he failed to disclose material facts on his Form U4.

Hutcheson's suspension began January 3, 2005, and will conclude at the close of business February 2, 2005. (NASD Case #C8A040101)

James Lee Johnstone (CRD #2357330, Registered Representative, Houston, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$25,000 and suspended from association with any NASD member in any capacity for 18 months. The fine must be paid before Johnstone reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Johnstone consented to the described sanctions and to the entry of findings that he made material written representations to a public customer in connection with the sale of securities that were false in that a deferred variable annuity has no guaranteed contract value and there can be no assurance that an investment in mutual fund shares will not decrease in value. The findings also stated that Johnstone recommended and effected the sale of Class B mutual fund shares in the aggregate amount of \$1,093,000 to a public customer without reasonable grounds for believing the recommendations and transactions were suitable for the customer on the basis of his financial situation and needs.

Johnstone's suspension began January 3, 2005, and will conclude July 2, 2006. (NASD Case #C05040083)

Gregory Adam Jurkiewicz (CRD #2582435, Registered Representative, Dunedin, Florida) was barred from association with any NASD member in any capacity and ordered to pay \$1,729.86, plus interest, in restitution to a public customer. The sanctions were based on findings that Jurkiewicz failed to respond to NASD requests for information and that he made unsuitable recommendations to public customers. The findings also stated that Jurkiewicz negligently failed to disclose material information when he recommended that a public customer purchase mutual funds and failed to disclose that Class B shares of mutual funds incurred higher annual internal expenses than Class A shares, that Class A shares were available at discounted charges for purchases exceeding certain dollar amounts, and that he would receive a higher commission if the customer purchased Class B shares. (NASD Case #C3A040020)

Frank A. Katona (CRD #2620194, Registered Representative, Porte Madera, California) submitted an Offer of Settlement in which he was suspended from association with any NASD member in any capacity for one year and required to requalify by exam before acting in any registered capacity with any NASD member. In light of the financial status of Katona, no monetary sanctions have been imposed. Without admitting or denying the allegations, Katona consented to the described sanctions and to the entry of findings that he substantially participated in the sale of unregistered securities. The findings also stated that Katona entered into an arrangement with the principals of a private company to help raise money by selling "to be issued" shares to public customers and failed to tell them that 25 percent of

the money they invested was compensation to him. NASD also found that Katona failed to amend his Form U4 to disclose material information.

Katona's suspension began December 6, 2004, and will conclude at the close of business December 5, 2005. (NASD Case #CAF040020)

Herbert Ivan Kay (CRD #1374570, Registered Principal, Tucson, Arizona) was barred from association with any NASD member in any capacity. The sanction was based on findings that Kay engaged in private securities transactions and failed to provide prior written notice to his member firm. (NASD Case #C3A030015)

Jerald Michael Kennedy (CRD #4163151, Registered Representative, Columbus, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000, with credit for \$2,300 in commissions that Kennedy's member firm disallowed, and suspended from association with any NASD member in any capacity for three months with credit for 45 of the 90 days for the days that he was suspended by his member firm. Without admitting or denying the allegations, Kennedy consented to the described sanctions and to the entry of findings that he affixed the signatures of public customers, without their knowledge or approval, on switch letters that explain the actual or potential charges associated with selling mutual funds from one fund family and purchasing mutual funds in another fund family.

Kennedy's suspension began January 3, 2005, and will conclude at the close of business February 16, 2005. (NASD Case #C8A040108)

Elliot J. Kozak (CRD #4686042, Associated Person, Forest Hills, New York) submitted an Offer of Settlement in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for seven months. The fine must be paid before Kozak reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Kozak consented to the described sanctions and to the entry of findings that he willfully failed to disclose material information on his Form U4.

Kozak's suspension will begin January 18, 2005, and will conclude at the close of business August 17, 2005. (NASD Case #C10040097)

Ibrahim Ethem Kurtulus (CRD #2287372, Registered Representative, Staten Island, New York) submitted an Offer of Settlement in which he was fined \$7,500 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Kurtulus consented to the described sanctions and to the entry of findings that he opened brokerage

accounts for public customers at his member firm without the knowledge, authorization, or consent of the customers. The findings also stated that Kurtulus effected transactions in the accounts of public customers that he had opened without the customers' consent.

Kurtulus' suspension began December 6, 2004, and concluded at the close of business December 17, 2004. **(NASD Case #C10040030)**

Brian Ladah (CRD #1013931, Registered Principal, San Francisco, California) submitted an Offer of Settlement in which he was fined \$5,000, suspended from association with any NASD member in any capacity for two years, and ordered to disgorge \$49,200, plus interest, of commissions in restitution to public customers. The fine and restitution amounts must be paid before Ladah reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Ladah consented to the described sanctions and to the entry of findings that he engaged in private securities transactions outside the normal scope of employment with his member firm and failed to give prior written notice to, and receive approval from, his member firm. The findings also stated that Ladah engaged in outside business activities without providing prompt written notice to his member firm.

Ladah's suspension will begin January 18, 2005, and will conclude at the close of business January 17, 2007. **(NASD Case #C11040038)**

John Charles Levy (CRD #2138964, Registered Representative, Midland, Michigan) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Levy reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Levy consented to the described sanctions and to the entry of findings that he created a pledge agreement to assist a public customer attempting to use his account with Levy's member firm as collateral for a loan, signed the pledge agreement, and delivered the pledge agreement to the customer who submitted it to the bank even though it had not been approved or authorized by Levy's firm.

Levy's suspension began January 3, 2005, and will conclude July 2, 2005. **(NASD Case #C8A040104)**

Robert Stephen Marche (CRD #2709142, Registered Representative, Sherwood, Illinois) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD

member in any capacity for 10 days. The fine must be paid before Marche reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Marche consented to the described sanctions and to the entry of findings that he effected discretionary transactions in the accounts of a public customer pursuant to verbal authority without prior written authorization from the customer and prior written acceptance of the accounts as discretionary by his member firm. The findings also stated that Marche placed orders for transactions in securities accounts maintained at his former member firm without notifying the firm that he had become associated with another member firm and without notifying his new member firm that he had the securities accounts at his former firm.

Marche's suspension began January 3, 2005, and concluded at the close of business January 12, 2005. **(NASD Case #C8A040103)**

Craig Robert McCasland (CRD #4245011, Registered Representative, Steubenville, Ohio) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for 30 business days and three months. The fine must be paid before McCasland reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, McCasland consented to the described sanctions and to the entry of findings that he failed to submit timely an amended Form U4 disclosing material information and failed to respond in a timely manner to an NASD request for information.

McCasland's suspension will begin January 18, 2005, and will conclude at the close of business May 27, 2005. **(NASD Case #C8A040110)**

Ross James McVey, Jr. (CRD #2336041, Registered Representative, Oshkosh, Wisconsin) was barred from association with any NASD member in any capacity. The sanction was based on findings that McVey prepared and submitted documents on which the purported signatures of public customers were affixed without their knowledge or consent so that he could obtain payments for financial plans that he did not provide to the customers; as a result, the customers were improperly charged fees totaling more than \$120,000 that were paid to and used by McVey. The findings also stated that McVey failed to respond to NASD requests to appear and provide testimony. **(NASD Case #C8A040020)**

Arthur James Menlove (CRD #1636358, Registered Representative, Ann Arbor, Michigan) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity.

Without admitting or denying the allegations, Menlove consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information, documents, and to appear to give testimony. (NASD Case #C8A040113)

Brian Clark Miller (CRD #4390730, Registered Representative, Bryan, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Miller consented to the described sanction and to the entry of findings that he received \$4,215.26 in insurance premium payments from customers of an insurance affiliate of his member firm, improperly withheld the payments, and deposited the money in his operating bank account, thereby converting the funds to his own personal use and benefit without the knowledge or consent of the customers or the insurance affiliate. (NASD Case #C05040078)

Deepak Shankardas Mirchandani (CRD #4380477, Registered Representative, Flushing, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for three months. Without admitting or denying the allegations, Mirchandani consented to the described sanctions and to the entry of findings that he falsified the social security number of a client on an insurance application as an accommodation to the customer who was in the process of marrying a United States citizen and was awaiting citizenship documentation and a valid social security number.

Mirchandani's suspension will begin January 18, 2005, and will conclude at the close of business April 18, 2005. (NASD Case #CLI040032)

Mark John Moeller (CRD #2469139, Registered Representative, Birmingham, Michigan) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Moeller consented to the described sanction and to the entry of findings that he received a \$3,681 dividend check payable to a public customer, failed to place the funds into the customer's investment account as directed, and deposited the check bearing a forged endorsement of the customer into his personal checking account without the customer's knowledge and consent and used the funds for his own use and benefit and not for the benefit of the customer. The findings also stated that Moeller failed to respond to NASD requests for information, documentation, and to appear to give testimony. (NASD Case #C8A040106)

Gary Lee Myers (CRD #2150840, Registered Representative, Monaca, Pennsylvania) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any capacity for six months. The fine must be paid before Myers reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Myers consented to the described sanctions and to the entry of findings that he willfully failed to amend his Form U4 to disclose material information.

Myers' suspension began January 3, 2005, and will conclude July 2, 2005. (NASD Case #C9A040052)

Alfred Sinclair Olsen, IV (CRD #2742717, Registered Principal, Spokane, Washington) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any principal capacity for one year. Olsen also consented to testify if NASD files disciplinary proceedings against his former member firm's current or former agents relating to the misconduct referenced in this AWC. Without admitting or denying the allegations, Olsen consented to the described sanctions and to the entry of findings that, as the supervisor for the registered representatives of his member firm, he was unable to monitor reasonably their sales activities. The findings also stated that although Olsen knew, or should have known, that he would be unable to supervise reasonably such a large number of geographically disbursed registered representatives, he continued to act as supervisor while fraudulent and deceptive sales practices, material misrepresentations, and unsuitable recommendations persisted at his firm. NASD also found that the supervisory action taken by Olsen in the face of red flags indicating improper sales practices was inadequate in that he reviewed and approved subscription agreements that indicated the proprietary products were not suitable for the investing customers.

Olsen's suspension began December 6, 2004, and will conclude at the close of business December 5, 2005. (NASD Case #C3B040027)

Albert Vincent Otero (CRD #354159, Registered Representative, Dobbs Ferry, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$3,500 and suspended from association with any NASD member in any capacity for 10 business days. Without admitting or denying the allegations, Otero consented to the described sanctions and to the entry of findings that he wrote checks totaling \$404 to a public customer to prevent the customer from making complaints to Otero concerning contingent deferred sales charges relating to the customer's account without the knowledge or approval of Otero's member firm.

Otero's suspension began January 3, 2005, and concluded at the close of business January 14, 2005. (NASD Case #C11040039)

Kristi Ann Parrott (CRD #3042980, Associated Person, Arlington, Texas) was barred from association with any NASD member in any capacity. The sanction was based on findings that Parrott prepared correct bank slips for deposit of her member firm's daily receipts into various accounts at the firm's clearing firm but transmitted false electronic lists to the clearing firm to divert approximately \$23,168.70 into her personal account, which she quickly withdrew by check or ATM. The findings also stated that Parrott accomplished the diversion of funds by falsifying the amounts of deposit to her account, duplicating the amount of deposit to her account on the electronic list, or by listing fictitious deposits to her account on the electronic list. NASD also found that to conceal her conduct, Parrott used other employees' electronic IDs when transmitting fraudulent electronic lists to the clearing firm and destroyed copies of the relevant deposit slips. (NASD Case #C06040019)

Steve R. Pearson (CRD #4315047, Registered Representative, Skiatook, Oklahoma) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Pearson consented to the described sanction and to the entry of findings that he received \$59,798.79 in insurance premium payments from customers of an insurance affiliate of his member firm; improperly withheld the payments; and deposited the money in his operating bank account, thereby converting the funds to his own personal and business use and benefit without the knowledge or consent of the customers or the insurance affiliate. The findings also stated that Pearson issued false receipts for payments and fraudulent Memorandums of Insurance, including nonexistent policy numbers to satisfy inquiring customers. (NASD Case #C05040079)

Raul Peralta (CRD #4547226, Associated Person, Chicago, Illinois) was barred from association with any NASD member in any capacity. The sanction was based on findings that he affixed the signature of a public customer as an endorsement on a \$2,667.47 check that had been made payable to the customer and cashed the check without the customer's knowledge, consent, or authorization, thereby misusing customer funds. The findings also stated that Peralta failed to respond to NASD requests for information. (NASD Case #C8A040062)

James Bernard Peterson, Sr. (CRD #1370895, Registered Representative, Hinsdale, Illinois) was fined \$15,000 and suspended from association with any NASD member in any

capacity for 13 months. The fine is due and payable when and if Peterson seeks to return to the securities industry. The sanctions were based on findings that Peterson failed to effect promptly a transaction in response to a public customer's direction. The findings also stated that Peterson attempted to settle a complaint away from his member firm by offering to pay the customer for the loss caused by Peterson's delay in moving variable annuity sub-accounts. NASD also found that Peterson failed to respond to NASD requests for information and documents in a timely manner.

Peterson's suspension began December 6, 2004, and will conclude at the close of business January 5, 2006. (NASD Case #C8A040034)

Randal Anthony Pitino (CRD #2366765, Registered Representative, Huntington, New York) was barred from association with any NASD member in any capacity. The sanction was based on findings that Pitino failed to respond to NASD requests for information. The findings also stated that Pitino executed unmatched transactions and to conceal his misconduct, submitted trade orders that did not represent bona fide customer orders and/or delayed submitting the trade information to conceal the time lag between the two legs of a seemingly matched transaction. (NASD Case #C10040051)

Kyle Edward Pittenger (CRD #2822088, Registered Principal, Geneseo, Illinois) submitted a Letter of Acceptance, Waiver, or Consent in which he was fined \$10,000 and suspended from association with any NASD member in any capacity for three months. The fine must be paid before Pittenger reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Pittenger consented to the described sanctions and to the entry of findings that he engaged in outside business activities and failed and neglected to provide prompt written notice to his member firm.

Pittenger's suspension will begin January 18, 2005, and will conclude April 17, 2005. (NASD Case #C8A040111)

David Allen Regis (CRD #868184, Registered Representative, Arlington, Texas) was barred from association with any NASD member in any capacity. The sanction was based on findings that Regis failed to respond to NASD requests to appear and give testimony. The findings also stated that Regis engaged in private securities transactions without prior written notice to his member firm describing the proposed transaction, his proposed role in the transaction, and stating whether he had received, or might receive, compensation. NASD also found that Regis was never registered as a general securities representative and that the

payphone investment contracts he sold to public customers did not fall within any of the permissible categories he was allowed to sell. (NASD Case #C06040017)

Earl Lee Richardson (CRD #2218514, Registered Supervisor, Houston, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$5,000 and suspended from association with any NASD member in any principal capacity for 30 business days. Without admitting or denying the allegations, Richardson consented to the described sanctions and to the entry of findings that he failed and neglected to supervise adequately a registered representative who recommended and effected the sale of Class B mutual fund shares in the aggregate amount of \$1,093,000 to a public customer without having a reasonable basis for believing the recommendations and transactions were suitable for the customer on the basis of the customer's financial situation and needs. The findings also stated that Richardson approved the transactions without sufficiently investigating whether the customer's investment objectives could have been achieved through an investment in Class A shares where the customer would have been able to take advantage of breakpoints.

Richardson's suspension began December 6, 2004, and concluded at the close of business January 14, 2005. (NASD Case #C05040080)

Scott Paul Richmond (CRD #2895009, Registered Representative, Leawood, Kansas) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Richmond consented to the described sanction and to the entry of findings that he misused the funds of public customers totaling \$100,742.59 without the knowledge, consent, or authorization of the customers. The findings also stated that Richmond failed to respond to NASD requests for information. (NASD Case #C04040058)

Edward Francis Sadowski (CRD #832094, Registered Principal, Neptune, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$10,000, suspended from association with any NASD member in any capacity for two years, and ordered to pay \$60,070, plus interest, in restitution to public customers. The fine and restitution amounts must be paid before Sadowski reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Sadowski consented to the described sanctions and to the entry of findings that he recommended that a public customer surrender variable annuities and purchase new variable annuities without having a reasonable basis for believing the recommendations were suitable based upon the customer's investment objectives,

financial situation, and needs, causing the customer unnecessarily incurred surrender charges while Sadowski earned commissions for purchases of comparable products. The findings also stated that Sadowski knowingly charged public customers a fee for market-timing services that he did not and could not perform.

Sadowski's suspension began January 3, 2005, and will conclude at the close of business January 2, 2007. (NASD Case #C9B040102)

Cantwell Paul Sandifur, Jr. (CRD #1208656, Registered Principal, Spokane, Washington) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Sandifur also consented to testify if NASD files disciplinary proceedings against the firm's current or former agents relating to the misconduct referenced in this AWC. Without admitting or denying the allegations, Sandifur consented to the described sanction and to the entry of findings that registered representatives of a member firm, under his direction and control, engaged in fraudulent and deceptive sales practices by making material misrepresentations and omitting material facts with the sale of proprietary products to public customers without an adequate basis for recommending the proprietary products to customers for whom the sales were unsuitable. The findings also stated that Sandifur and the firm's compliance officer spent the majority of their time working as officers and/or directors of affiliated companies, and the compliance officer delegated his responsibilities to others who were unqualified, inexperienced, and unable to perform the delegated tasks due to insufficient staffing.

NASD also found that Sandifur knew, or should have known, that the compliance officer and the supervisor of all the registered representatives were not effectively discharging their responsibilities. In addition, NASD found that Sandifur, as president of the firm, was responsible for establishing an effective supervisory system at the firm, but the firm's supervisory system was not reasonably designed to achieve compliance with applicable securities laws, regulations, and NASD rules regarding monitoring the sales activities and recommendations of registered representatives; was not reasonably designed to achieve compliance training for sales presentations of proprietary products; and did not provide guidance concerning the risk level and suitability of proprietary products for investors with a low to medium risk tolerance and/or preservation of capital as a primary investment objective. (NASD Case #C3B040028)

James A. Scavuzzo (CRD #4764317, Associated Person, Sicklerville, New Jersey) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or

denying the allegations, Scavuzzo consented to the described sanction and to the entry of findings that he failed to respond to NASD requests for information. (NASD Case #C9B040101)

Kevin Paul Schwendemann (CRD #4799095, Associated Person, Glendale, New York) submitted a Letter of Acceptance, Waiver, and Consent in which he was fined \$2,500 and suspended from association with any NASD member in any capacity for 45 days. The fine must be paid before Schwendemann reassociates with any NASD member following the suspension or before requesting relief from any statutory disqualification. Without admitting or denying the allegations, Schwendemann consented to the described sanctions and to the entry of findings that he failed to disclose a material fact on his Form U4.

Schwendemann's suspension began December 20, 2004, and will conclude at the close of business February 2, 2005. (NASD Case #CLI040030)

Ramy M. Shaalan (CRD #4496492, Registered Representative, Washington, DC) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Shaalan consented to the described sanction and to the entry of findings that he wrongfully obtained approximately \$96,000 from his member firm and converted the funds to his own use and benefit. NASD also found that Shaalan, in perpetrating the scheme, established a bank account under the name of a fictitious entity of which he was the purported owner. The entity's name was substantially similar to the name of an actual company with which his firm had a business relationship and had on occasion in the past provided business services to the firm. The findings also stated that using an invoice the firm had received from the actual vendor, Shaalan created an invoice template for the fictitious company and on various occasions generated false invoices for services the fictitious company purportedly provided the firm, submitting the false invoices to the firm for payment. The findings further stated that at Shaalan's request, the checks issued to pay the false invoices were given to him to be transmitted to the fictitious company. Moreover, the findings stated that Shaalan endorsed the checks and deposited them into the bank account he had established in the name of the fictitious company, thereby converting the funds to his own use and benefit. (NASD Case #C9A040050)

Carlos Akira Shibata (CRD #3101238, Registered Representative, Miami, Florida) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Shibata consented to the described sanction and to the entry of findings that he converted approximately \$290,000 of a public

customer's funds. The findings also stated that Shibata failed to respond to NASD requests to appear to give testimony and to provide documents. (NASD Case #C07040099)

Brian Thomas Slich (CRD #4025395, Registered Representative, Metairie, Louisiana) was barred from association with any NASD member in any capacity. The sanction was based on findings that Slich unlawfully withdrew \$10,514.19 from the bank accounts of public customers and converted the funds to his own use and benefit. The findings also stated that Slich failed to respond to NASD requests for information. (NASD Case #C05040025)

Elise Clydean Tanner (CRD #1142274, Registered Representative, Seattle, Washington) submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Tanner consented to the described sanction and to the entry of findings that she misused the funds of a public customer totaling \$15,000 without the knowledge, consent, or authorization of the customer. The findings also stated that Tanner failed to respond to NASD requests for information. (NASD Case #C04040055)

Galina Tedeeva (CRD #4491864, Registered Representative, Forest Hills, New York) submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Tedeeva consented to the described sanction and to the entry of findings that she arranged for an imposter to take the Series 6 and Series 63 qualification exams on her behalf. (NASD Case #CLI040035)

Lacy McClure Walthall, III (CRD #713269, Registered Regulation, Wake Forest, North Carolina) was fined \$35,000, suspended from association with any NASD member in any capacity for one year, and ordered to requalify by exam as a general securities representative (Series 7) before re-entering the securities industry. The sanctions were based on findings that Walthall engaged in outside business activities and private securities transactions without prompt written notification to his member firm and his firm's written approval to engage in the private securities transactions.

Walthall's suspension began December 20, 2004, and will conclude at the close of business December 19, 2005. (NASD Case #C07040048)

Eloise Ruth Worden (CRD #2654863, Registered Principal, Denton, Texas) submitted a Letter of Acceptance, Waiver, and Consent in which she was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Worden consented to the described

sanction and to the entry of findings that, as the treasurer of a condominium association, she misused funds totaling \$3,800 belonging to the association without the knowledge, consent, or authorization of the association. (NASD Case #C04040054)

Matthew Philip Wright (CRD #4097839, Registered Representative, Kingsport, Tennessee) submitted a Letter of Acceptance, Waiver, and Consent in which he was barred from association with any NASD member in any capacity. Without admitting or denying the allegations, Wright consented to the described sanction and to the entry of findings that he forged the signature of his manager on blank checks from a bank account of an affiliate of his member firm and attempted to negotiate one of the checks for \$10,000 by depositing the check into his personal bank account to apply the funds to satisfy personal debt. The forgeries and attempted conversion were done without the knowledge or consent of the firm's affiliate. (NASD Case #C05040085)

Decision Issued

The following decision has been issued by the Office of Hearing Officers and has been appealed to or called for review by the NAC as of December 3, 2004. The findings and sanctions imposed in the decisions may be increased, decreased, modified, or reversed by the NAC. Initial decisions whose time for appeal has not yet expired will be reported in the next *Notice to Members*.

Joseph Rogala (CRD #1051594, Registered Representative, Glen Ellyn, Illinois) was barred from association with any NASD member in any capacity. The sanction was based on findings that Rogala affixed the signature of a public customer on a forged letter to countermand the customer's directive to stop automatic monthly withdrawals from the customer's checking account, thereby reinstating his commission. The findings also stated that Rogala provided false documentation to NASD. NASD also found that Rogala created and distributed misleading sales literature that failed to disclose material facts and that Rogala failed to obtain prior written approval from his firm for the sales literature.

This decision has been appealed to the NAC, and the sanction is not in effect pending consideration of the appeal. (NASD Case #C8A030089)

Complaints Filed

NASD issued the following complaints. Issuance of a disciplinary complaint represents the initiation of a formal proceeding by NASD in which findings as to the allegations in

the complaint have not been made, and does not represent a decision as to any of the allegations contained in the complaint. Because these complaints are unadjudicated, you may wish to contact the respondents before drawing any conclusions regarding the allegations in the complaint.

Thomas James Carr (CRD #1613787, Registered Representative, Encinitas, California) was named as a respondent in an NASD complaint alleging that he effected transactions in the account of a public customer without the knowledge and consent of the customer, and without having a reasonable basis for believing that the recommendations were suitable for the customer on the basis of the facts disclosed by the customer as to its other security holdings, financial situation, and needs. The complaint also alleges that Carr failed to respond to NASD requests for information. (NASD Case #C01040029)

John Barry Chambers (CRD #2136192, Registered Representative, Dallas, Texas) was named as a respondent in an NASD complaint alleging that, in connection with the purchase of purported shares by public customers in a company he had recently formed and inducements for the purchases, Chambers, directly or indirectly, by the use of means or instrumentalities of interstate commerce or the mails, employed artifices, devices, or schemes to defraud; made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; engaged in acts, practices, or courses of business that operated or would operate as a fraud or deceit; and/or effected transactions in, or induced the purchase or sale of, securities by means of manipulative, deceptive, or other fraudulent devices or contrivances.

The complaint also alleges that Chambers induced public customers to submit to his company or its agent approximately \$180,600 for investing in the company and, without the knowledge, authorization, or consent of the customers, used a large portion, if not virtually all, of the customer funds for his own use and benefit, thereby misusing and/or converting the funds. In addition, the complaint alleges that Chambers recommended that public customers invest in his company without reasonable grounds to believe the investments were suitable for the customers in light of their financial situation, investment objectives, needs, and the risks associated with the investments. Furthermore, the complaint alleges that Chambers engaged in private securities transactions and outside business activities without prompt prior written notice to his member firm. Moreover, the complaint alleges that Chambers willfully failed to amend and to amend timely his Form U4 with material information. (NASD Case #CLI040031)

James Anthony Dvorznak (CRD #2874901, Registered Representative, Bethpage, New York) was named as a respondent in an NASD complaint alleging that he effected, or caused to be effected, unauthorized purchases of common stock in the accounts of public customers. The complaint also alleges that Dvorznak failed to respond to NASD requests to appear to give testimony. (NASD Case #C07040097)

Scott Michael Epstein (CRD #4268699, Registered Representative, Marlboro, New Jersey) was named as a respondent in an NASD complaint alleging that he engaged in a pattern of unsuitable mutual fund switching in the accounts of public customers without having reasonable grounds for believing that the transactions were suitable for the customers in view of the nature of the recommended transactions, and in light of the customers' financial situations, investment objectives, circumstances, and needs. The complaint also alleges that, in addition to the switch transaction, Epstein recommended that customers invest in funds utilizing proceeds from other funds that were nearly identical, thereby incurring higher annual expenses and lower returns. In addition, the complaint alleges that Epstein also recommended that a customer invest in Bond Funds utilizing proceeds from an IRA account. The complaint further alleges that in connection with the mutual fund recommendations to customers, Epstein, by use of the instrumentalities of interstate commerce or the mails, intentionally or recklessly, employed devices to defraud customers by making untrue statements of material facts or omitting material facts necessary to make the statements, in light of the circumstances in which they were made, not misleading. (NASD Case #C9B040098)

Juan Carlos Ly (CRD #2520403, Registered Representative, Maiden, North Carolina) was named as a respondent in an NASD complaint alleging that he recommended that public customers of his former member firm switch their variable annuities to a variable annuity with his new member firm without a reasonable basis for recommending the switches and failed to verify the relative cost structures of the annuities and did not know that the cost structure for the variable annuity with his new firm would be higher. The complaint also alleges that Ly misrepresented on his firm's Variable Products Broker/Dealer Account Form that a variable annuity had a lower cost structure than the annuity being relinquished. (NASD Case #C07040092)

Edward Alan Martin (CRD #2193457, Registered Principal, Franklin, Tennessee) was named as a respondent in an NASD complaint alleging that he received \$40,000 intended for investment advisory services from a public customer, deposited the check into a personal account without the knowledge or consent of either the customer or his member firm, and used the funds for business and personal expenses, thereby converting the funds to his own use and benefit. The complaint also alleges that Martin told his member firm that

the customer had not renewed the advisory services agreement, but when confronted by his member firm, he remitted \$40,000 to the firm. The complaint further alleges that Martin converted \$6,000 belonging to his member firm by retaining the amount of the advisory fee to which the firm was entitled in excess of his compensation. (NASD Case #C05040084)

Joseph Peter Orozco (CRD #1019164, Registered Representative, Burbank, California) was named as a respondent in an NASD complaint alleging that he received \$471,280.09 from a public customer to purchase variable annuities, forwarded the check to his member firm, which was unable to process the check because it was made payable to the firm's former clearing firm, and returned the check to Orozco. The complaint also alleges that Orozco failed to tell the customer that his firm had returned the check, that he never purchased the variable annuities on the customer's behalf, and that he maintained possession of the check, falsely representing to the customer that it had been deposited and the annuities purchased. In addition, the complaint alleges that Orozco reported to his member firm that he had not received any customer correspondence even though he had received letters from his customer inquiring about the status of the accounts. Furthermore, the complaint alleges that Orozco provided false statements to the public customer and his member firm regarding the status of the variable annuities he allegedly purchased, and to his member firm regarding the receipt of customer correspondence. Moreover, the complaint alleges that Orozco failed to complete an NASD on-the-record interview. (NASD Case #C02040045)

Douglas Alan Rauh (CRD #1465225, Registered Principal, Laguna Niguel, California) was named as a respondent in an NASD complaint alleging that he willfully failed to disclose material information on his Forms U4. The complaint also alleges that Rauh exercised discretion in the accounts of public customers without their prior written authorization to exercise such discretionary power by the customers and without receiving written acceptance of the discretionary accounts by his member firm. In addition, the complaint alleges that Rauh effected transactions in the account of a public customer without reasonable grounds for believing such transactions were suitable for the customer in view of the size, frequency, concentration of speculative securities, and nature of the recommended transactions in light of the customer's financial situation, investment objectives, circumstances, and needs. Furthermore, the complaint alleges that Rauh executed options trades in the account of a public customer without reasonable grounds for believing that the customer was capable of evaluating the transactions risks and financially able to bear the risks of the recommendations, and that the trades were suitable. (NASD Case #C02040044)

Firms Suspended for Failure to Supply Financial Information

The following firms were suspended from membership in the NASD for failure to comply with formal written requests to submit financial information to NASD. The action was based on the provisions of NASD Rule 9552. The date the suspension commenced is listed after the entry. If the firm has complied with the requests for information, the listing also includes the date the suspension concluded.

Archon Securities, LLC
Phoenix, Arizona
(December 10, 2004)

Joseph Wrobel
Las Vegas, Nevada
(November 22, 2004)

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

Aristatrade Securities, LLC
Astoria, New York
(November 30, 2004)

Intra Network Securities
Rancho Santa Fe, California
(December 13, 2004)

Investmentpost Inc.
Augusta, Georgia
(December 9, 2004)

Individuals Suspended Pursuant to NASD Rule 9552 for Failure to Provide Information Requested Under NASD Rule 8210

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

Lazariw, Rosemary L.
Tampa, Florida
(December 6, 2004)

Siddons, Daniel R.
West Chester, Pennsylvania
(December 7, 2004)

Individual Barred Pursuant to NASD Rule 9552 for Failure to Provide Information Requested under NASD Rule 8210

(The date the bar became effective is listed after the entry.)

Fernandez, George I.
Miami, Florida
(December 6, 2004)

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

Apgar, Justin E.
Wall Township, New Jersey
(November 30, 2004)

Koppel, Yakov (Jack)
Loch Sheldrake, New York
(November 30, 2004)

McClure, Randy L.
Dunedin, Florida
(December 9, 2004)

Pearson Jr., Dennis A.
San Diego, California
(December 13, 2004)

Sosa, Eduardo X.
New York, New York
(December 9, 2004)

Individual Suspended Pursuant to NASD Rule Series 9510 for Failure to Comply with an Arbitration Award or a Settlement Agreement

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

Barton, Frederick J.
Atlanta, Georgia
(December 6, 2004)

Edward Jones to Pay \$75 Million to Settle Revenue Sharing Charges

The SEC, NASD and the New York Stock Exchange (NYSE) announced settled enforcement proceedings against Edward D. Jones & Co., L.P., a registered broker-dealer headquartered in St. Louis, Missouri, related to allegations that Edward Jones failed to adequately disclose revenue sharing payments that it received from a select group of mutual fund families that Edward Jones recommended to its customers.

As part of the settlement of all three proceedings, Edward Jones will pay \$75 million in disgorgement and civil penalties. All of that money will be placed in a Fair Fund for distribution to Edward Jones customers. Edward Jones also agreed to disclose on its public Web site information regarding revenue sharing payments and hire an independent consultant to review and make recommendations about the adequacy of Edward Jones' disclosures.

According to an Order issued by the SEC, Edward Jones entered into revenue sharing arrangements with seven mutual fund families, which Edward Jones designated as "Preferred Mutual Fund Families."

Edward Jones told the public and its clients that it was promoting the sale of the Preferred Families' mutual funds because of the funds' long-term investment objectives and performance. At the same time, Edward Jones failed to disclose that it received tens of millions of dollars from the Preferred Families each year, on top of commissions and other fees, for selling their mutual funds. Edward Jones also failed to disclose that such payments were a material factor, among others, in becoming and remaining an Edward Jones Preferred Family. Edward Jones provided the Preferred Families with certain benefits not otherwise available to non-preferred families including, among other things, exclusive shelf space for the sale and marketing of their funds and exclusive access to Edward Jones' investment representatives (IRs) and customer base. Edward Jones also exclusively promoted the 529 college savings plans offered by its Preferred Families over all other 529 plans that it had available to sell.

Linda Chatman Thomsen, Deputy Director of the SEC's Division of Enforcement, said, "Edward Jones' undisclosed receipt of revenue sharing payments from a select group of mutual fund families created a conflict of interest. When customers purchase mutual funds, they should be told about the full nature and extent of any conflict of interest that may affect the transaction. Edward Jones failed to do that."

Merri Jo Gillette, Regional Director of the SEC's Midwest Regional Office, added, "Edward Jones made affirmative representations to investors regarding its purported reasons for recommending the mutual funds offered by the seven Preferred Families, but failed to inform investors of one

important factor: that it was being paid undisclosed compensation by those fund families. By not telling investors the whole story, Edward Jones violated the federal securities laws."

"Beyond its disclosure failures, Edward Jones engaged in other activities that violate NASD rules aimed at precluding conflicts of interest—including accepting directed brokerage payments and staging a sales contest to promote the Preferred Funds," said Barry Goldsmith, NASD Executive Vice President and Head of Enforcement. "These kinds of activities increase the potential for investors to be steered into investments that serve the financial interests of the firm and its representatives instead of the best interest of the customers."

"Firms have a responsibility to supervise all their business activities," said Susan Light, Vice President of Enforcement, NYSE Regulation. "Edward Jones's supervisory lapses are especially troubling in this case because of the direct conflict between the firm and its customers."

According to the Commission's Order, Edward Jones had entered into selling agreements with approximately 240 mutual fund families, but only the seven Preferred Families made these payments to Edward Jones. Edward Jones, its general and limited partners, and its IRs received financial benefits from the Preferred Families' payments. Edward Jones exclusively promoted the Preferred Families' funds over all other mutual funds. Historically, over 95 percent of Edward Jones' sales of mutual fund shares have been sales of the seven Preferred Families.

In NASD's separate settlement, in addition to the receipt of direct revenue sharing payments, NASD found that the firm gave preferential treatment to the Preferred Funds in exchange for millions of dollars in directed brokerage from three of the Preferred Fund families. This violates NASD's "Anti-Reciprocal Rule," Conduct Rule 2830(k), which prohibits regulated firms from favoring the distribution of shares of particular mutual funds on the basis of brokerage commissions to be paid by the fund companies.

NASD also charged Edward Jones with holding an unlawful sales contest in the fall of 2002. Winning brokers could choose a trip from among a list of 35 "world class" vacation destinations, such as Singapore, St. Martin, Davos, Biarritz and Tortola. These sales contests, which were held every six months, rewarded the winners with airfare, five-star accommodations, and treats attendees to activities such as skiing, golfing, fine dining, and tours. During October 2002, Edward Jones changed the contest rules and only credited sales of funds that were on the Preferred Funds list. This violates NASD rules that prohibit product-specific sales contests that credit the sale of certain, but not all, fund sales. Indeed, some brokers complained that "doing the right thing

for the client” (by recommending non-preferred funds and variable annuities) penalized their chance to earn a sales contest trip.

NASD also found that the firm failed to retain e-mails, failed to supervise the late trading of mutual funds, and failed to supervise the activities relating to the Preferred Funds and revenue sharing, directed brokerage, and sales contests.

NYSE Regulation found that Edward D. Jones & Co.’s conduct was inconsistent with just and equitable principles of trade and failed to adhere to good business practices in violation of NYSE Rules 476 and 401. In violation of Rule 342, the firm failed to supervise its business with respect to revenue sharing agreements, late trading of mutual funds and email retention.

In addition to the \$75 million payment, Edward Jones has agreed to be censured and to cease and desist from committing or causing violations of Section 17(a)(2) of the Securities Act of 1933, Section 15B(c)(1) of the Securities Exchange Act of 1934 and Rule 10b-10 promulgated thereunder and Municipal Securities Rulemaking Board Rule G-15. The SEC’s Order further requires Edward Jones to comply with certain undertakings, including hiring an independent consultant to review and make recommendations about the adequacy of Edward Jones’ disclosures. Edward Jones has consented to the issuance of the SEC’s Order, without admitting or denying the findings contained therein.

NASD Fines H&R Block Financial Advisors \$500,000 for Enabling Deceptive Market Timing, Orders Payment of \$325,000 in Restitution

NASD Investigation of Individuals Involved in Scheme is Continuing

NASD censured and fined H&R Block Financial Advisors, Inc., \$500,000 for enabling a hedge fund customer in its Orlando, FL branch office to engage in deceptive practices to market time mutual funds. NASD also ordered H&R Block to pay \$325,000 to reimburse the affected funds.

“The deceptive market timing practices found in this investigation do more than just violate securities regulations—they have a profoundly negative impact on investor confidence” said Mary Schapiro, NASD Vice Chairman. “The enforcement action announced today, and similar cases we have brought in recent months, make clear that NASD expects firms to have enhanced procedures, systems, and practices to ensure that illicit market timing activities like these do not occur.”

NASD found that from October 2002 to July 2003, H&R Block, through the actions of two brokers in its Orlando office and the Orlando branch office manager, enabled one of the

brokers’ customers to evade mutual fund attempts to block or restrict the client’s market timing transactions. H&R Block recruited and hired the two brokers in September 2002 knowing the brokers were going to open accounts for hedge funds that intended to actively trade or market time in mutual funds that discouraged or limited such trading. Each of these clients was permitted to open fee-based accounts, even though the firm acknowledged that these accounts were not meant for investors primarily intending to market time. Because these customers were going to engage in market timing, H&R Block charged them a flat fee of 1 percent, which was higher than the customary fee for fee-based accounts of the same size.

NASD also found that the two Orlando brokers opened a total of 19 accounts for seven clients. The accounts held approximately \$32 million in assets. One of those hedge fund clients used seven different accounts to engage in deceptive market timing practices.

Through the Orlando brokers and the Orlando branch office manager, H&R Block enabled the Orlando customer, whose trading exceeded funds’ prospectus limitations, to evade fund restrictions. H&R Block received 44 restriction letters designed to block this hedge fund customer’s market timing activities. After H&R Block received these letters, the firm, through the Orlando brokers and branch office manager, enabled the hedge fund to use related accounts to continue trading in restricted funds. In addition, H&R Block allowed the customer to open two new accounts with funds from existing H&R Block accounts or from common bank accounts, and this customer used the new accounts to continue to market time funds that had restricted its related accounts. H&R Block also allowed the customer to open a related account with one of the firm’s brokers in New York City, and that account also market timed some mutual funds that had already restricted the customer’s other H&R Block accounts.

Through its deceptive conduct, the customer executed 64 fund purchases and sales that violated fund restrictions and made approximately \$325,000 from these violative trades.

NASD found that the Orlando brokers also attempted to help their clients avoid restriction letters by requesting that the firm change the broker of record on nine accounts from one of the two brokers to the other. One of the brokers also requested that the broker of record for one account be changed an Orlando branch house account. The Orlando branch office manager approved, and the firm processed, the requested transfers.

NASD also found that H&R Block failed to have adequate policies and procedures in place to prevent its brokers and clients from market timing mutual funds in violation of fund restrictions, and failed to adequately respond on a timely basis

to the red flags that would have alerted it to the efforts of the Orlando hedge fund customer and Orlando brokers to evade fund restrictions.

In settling with NASD, H&R Block neither admitted nor denied the allegations, but consented to the entry of NASD's findings.

NASD's investigation into the activities of particular individuals involved in this market timing scheme is continuing.

SEC, NASD Sanction Knight Securities \$79 Million for Fraudulent Sales to Institutional Customers Includes \$25 Million in Fines, \$41 Million in Ill-Gotten Gains, \$13 Million in Interest; NASD Investigation Into Activities of Individuals Involved in Scheme Continues

The SEC and NASD announced today that Knight Securities, L.P., now known as Knight Equity Markets, L.P., will pay over \$79 million to settle charges that it defrauded its institutional customers. Under this joint settlement, Knight will pay a \$12.5 million fine to NASD and a \$12.5 million civil penalty to the SEC. Knight is also ordered to pay \$41 million in ill-gotten profits and \$13 million in prejudgment interest into a Fair Fund established by the SEC for compensating harmed investors.

The SEC and NASD found that Knight's former leading institutional sales trader priced trades in a manner contrary to customers' expectations and industry custom, using deceptive trading practices to disguise his pricing and the amount of Knight's profits.

"Every firm has a fundamental obligation to trade honestly and fairly with its customers, regardless of the customers' level of sophistication," said NASD Vice Chairman Mary L. Schapiro. "Knight's fraudulent trading, extracting millions of dollars of excess profits from its institutional customers for two years, requires the strong sanctions imposed here."

During 1999 and 2000, the sales trader generated a total of approximately \$41 million in illegal profits for Knight executing orders from his institutional customers, including managers of mutual funds. The sales trader had Knight acquire a stock position after he received an institutional customer's order, and then waited until the price of the stock moved before executing trades to fill the customer's order, creating greater profits for Knight at the expense of his customer. If the price of the stock moved in favor of Knight's position, the sales trader delayed executions and traded with his customers at prices reflecting the positive price movement. If the price of the stock moved against Knight's position, the sales trader executed trades with customers based upon prices at an earlier time, which were more advantageous to Knight.

His customers did not know when, or at what prices, Knight acquired stock pursuant to their orders, and the sales trader took advantage of that in trading with them, making tens of millions of dollars in excessive profits at their expense.

The SEC and NASD also found that Knight failed to adequately supervise the sales trader's trading. The sales trader's supervisor and the former head of Knight's institutional sales department (the "desk supervisor") was his brother. The brothers had a profit-sharing arrangement, approved by Knight, which gave the desk supervisor half of the sales trader's trading compensation. This profit-sharing arrangement created an inherent conflict of interest with the desk supervisor's supervisory responsibilities for the sales trader's trading. While the sales trader was generating extraordinary profits in his trading with institutional customers, neither the desk supervisor nor anyone else at Knight conducted a meaningful review of the sales trader's trading. No one in a supervisory role questioned the extraordinary profits that the sales trader generated, or undertook any steps to see how he was making them.

Knight's institutional sales traders were also found to have reported thousands of trades improperly to ACT during the period from April 2000 through March 2001. Knight's traders improperly reported trades with .SLD modifiers (indicating a late trade report) and .PRP modifiers (indicating an execution that was supposed to have occurred earlier, based upon the price at a prior time) so Knight's trading system would accept trades that were executed at prices different from the inside market at the time the trades were reported. Despite the long-running problem, Knight did not take reasonable steps to educate traders about the use of ACT modifiers, or enforce a system to prevent the improper ACT reporting. The SEC and NASD sanctioned Knight for these supervisory failures.

NASD also found supervisory failures by Knight over trading in proprietary "back book" accounts used by some of Knight's employees for speculative trading. Traders received a higher percentage of profits generated in back book accounts than for profits in their market making accounts, giving them greater incentive to generate profits in the back book accounts. Knight did not have specific written supervisory procedures governing the use and supervision of those accounts.

In addition, NASD found that Knight had failed to produce documents in a timely manner to NASD during NASD's investigation. Knight also improperly reported to NASD that the desk supervisor and the sales trader had terminated their employment voluntarily, instead of advising NASD that they had been permitted to resign. The desk supervisor and the sales trader left Knight after the firm notified them that it wanted to terminate their employment. Knight filed forms

with NASD (Form U5) wrongly advising NASD that their terminations had been voluntary.

Knight agreed to the sanctions while neither admitting nor denying the allegations. NASD's investigation into the activities of particular individuals involved in this matter is continuing.

NASD Orders First Command to Pay \$12 Million for Misleading Statements in Sales of Systematic Investment Plans to Military Personnel

Firm to Pay Restitution, Fund Investor Education Program for Military Community

NASD censured and fined First Command Financial Planning Inc., a Fort Worth, TX broker-dealer, \$12 million for making misleading statements and omitting important information when selling mutual fund investments with up-front sales charges of up to 50 percent through a monthly installment method known as a "Systematic Investment Plan."

From that \$12 million, First Command is ordered to pay restitution to thousands of customers who purchased a Systematic Investment Plan between Jan. 1, 1999 and the present who terminated the plan and paid an effective sales charge greater than 5 percent. All money remaining will be payable to the NASD Investor Education Foundation, to be used for the investor education needs of members of the military and their families. The Foundation will use the funds to support educational programs, materials and research to help equip members of the military community with the knowledge and skills necessary to make informed investment decisions. It is anticipated that the Foundation will receive approximately \$8 million.

In the action announced today, First Command also settled NASD charges of inappropriately confronting a customer who complained, failing to maintain e-mail, failing to maintain adequate supervisory systems and procedures, and filing an inaccurate Form U-5 regulatory report. In a related action, NASD fined a First Command supervisor \$25,000 and suspended him from acting in any supervisory capacity for 30 days.

The SEC instituted settled enforcement proceedings against First Command based on similar allegations relating to the firm's sales of systematic investment plans.

"Using misleading sales scripts, inappropriate comparisons, and omissions of important information, First Command sold hundreds of thousands of complicated and often enormously expensive plans to young members of our armed services, who are frequently inexperienced investors," said NASD Vice Chairman Mary L. Schapiro. "These investors, like all others,

are entitled to balanced and honest information about investment alternatives. And it is inexcusable that a First Command sales supervisor would try to stifle an airman's complaint by suggesting, among other things, that sending his complaint violated Air Force regulations."

Under Systematic Investment Plans, an investor makes monthly payments for a fixed term, typically 15 years, which are invested in underlying mutual funds. The purchaser is charged a 50 percent sales load on the first 12 monthly payments. Payments over the remainder of the term are not subject to sales charges so that the effective sales charge decreases so long as the purchaser continues to make additional investments. However, if the investor does not terminate within 18 months, and then fails to complete the term, he or she will pay a sales charge of up to 50 percent of the amount invested. At the conclusion of NASD's investigation of this case, First Command informed NASD that it is eliminating the sale of new Systematic Investment Plans.

NASD found that First Command primarily sold the plans to commissioned and non-commissioned officers. The firm's customer base includes over 297,000 current and former military families. Forty percent of current active duty general officers, one-third of commissioned officers and 16 percent of noncommissioned officers are First Command clients. First Command's sales force consists primarily of former military personnel. Its executive officers, supervisors, managers and its Board of Advisors are primarily retired or separated military personnel.

NASD found that the firm sold the plans through the use of a three-step scripted sales process that contained misleading statements and omissions. For example:

- First Command emphasized in its sales that the 50 percent sales load would decrease to 3.3 percent upon completion of the term and that the high up-front sales charges increased the likelihood that an investor would complete the plan. However, the Firm's own data showed that historically, only 43 percent of its customers completed the 15-year term.
- First Command told its clients that a benefit of the high first-year sales charge was to "instill discipline." However, First Command failed to inform its customers of the lost earnings potential as a result of the sales charges deducted from the customer's first 12 months' investments. For example, an investor who made monthly payments of \$100, totaling \$1,200 in the first year, would be left with an investment in the funds of only \$600 for that year.

- First Command also made misleading statements when comparing their plan with other mutual fund investments, telling investors that no-load mutual funds were primarily for speculators and that no-load funds frequently have some of the highest long-term costs. In fact, the long-term costs of owning no-load funds are, on average, lower than owning load funds.
- First Command, in a training manual, cautioned its representatives when looking for prospects:
- *“Don’t ask or suggest to a ‘termite’ [a person who purchases term insurance, and invests the remainder in mutual funds] or ‘no loader’ [an individual who advocates the purchase of no-load mutual funds] who refuses to accept our philosophy that he talk with referrals. This is like voluntarily spreading a cancer in your market.”*

NASD also found that First Command violated NASD rules when a First Command supervisor inappropriately confronted a former customer—an Air Force officer—who complained in an e-mail to an online publication that he had suffered losses and recommended that others not invest with First Command. The e-mail was in response to a negative article about First Command’s sales practices.

First Command District Supervisor James Provo contacted the customer, suggested that he might need an attorney, told him that the highest level of Air Force commanders were being contacted regarding the e-mail and told him his previously approved change in assignment might be delayed until the matter was resolved. NASD also found that Provo arranged a meeting with the Air Force’s legal assistance office, questioning whether the customer had violated Air Force regulations by using e-mail to send his message criticizing First Command. Provo also contacted the customer’s squadron commander and informed her that First Command might have a grievance against a member of her squadron. First Command eventually wrote a letter of apology to the former client, but otherwise took no steps to discipline Provo.

In a separate action, NASD fined Provo \$25,000 and suspended him from serving in a supervisory capacity for 30 days. In settling the matter, Provo neither admitted nor denied the allegations, but consented to the entry of NASD’s findings.

In addition to making payments for restitution and investor education of military personnel and their families, First Command is required to hire an independent consultant to oversee the payment of restitution and review its sales practices. First Command must also pre-file its advertising materials with NASD for one year.

First Command agreed to the sanctions while neither admitting nor denying the allegations.

NASD issued *Systematic Investment Plans—Educate Yourself Before You Enlist*, an Investor Alert aimed at informing military and other investors about the risks of investing in Systematic Investment Plans.

NASD Fines Sigma Financial for Suing Customers in Violation of NASD’s Arbitration Code

Firm Pays Customers’ Legal Costs, Firm President Suspended

NASD censured and fined Sigma Financial Corporation of Ann Arbor, MI and its president, Jerome Rydell, \$135,000 for violating NASD’s Code of Arbitration Procedure—by frivolously pursuing legal action against an elderly couple who had won an arbitration award against the firm.

In addition, Rydell was suspended for 10 business days in all supervisory capacities. Sigma has reimbursed the elderly couple for the \$110,000 in attorney fees and costs they incurred in defending themselves for three years. NASD also ordered Sigma to certify annually, for a period of two years, that it has fully complied with the NASD Code of Arbitration Procedure in connection with any customer disputes. Sigma must also notify NASD prior to taking any legal action against customers in federal or state court.

The settlement resolves an NASD complaint filed against Sigma and Rydell in December 2003.

“This firm used the courts to carry out a campaign of harassment against two elderly customers because of an arbitration award it did not like—in clear violation of NASD rules and the firm’s own agreement with its customers,” said NASD Vice Chairman Mary L. Schapiro. “This kind of conduct will not be tolerated.”

As described in detail in an NASD News Release earlier this year, the couple filed an arbitration claim in July 1999 after losing money in investments they had made through the firm. In April 2001, following seven days of hearings, an NASD arbitration panel awarded the customers \$318,096, including attorney fees and costs. Unhappy with that result, Sigma, acting through Rydell, filed two lawsuits against the customers in Michigan Circuit Court later that same month.

The first lawsuit was an attempt to vacate the arbitration award. In the second lawsuit, Sigma claimed, for the first time, that it was entitled to damages as a third-party beneficiary to agreements the customers had signed with the issuer of the investments they had purchased through Sigma. Sigma did not seek to arbitrate this claim, despite NASD rules and its own agreement to arbitrate any controversy and waive its right to seek remedies in court.

The Michigan Circuit Court confirmed the arbitration award, dismissed Sigma's second lawsuit and sanctioned the firm \$500 for filing a frivolous claim. Nevertheless, Sigma continued to litigate against the elderly customers. On February 19, 2004, the Michigan Court of Appeals upheld the Circuit Court's confirmation of the arbitration award, dismissal of the third-party beneficiary lawsuit, and imposition of monetary sanctions.

Still not satisfied, Sigma, through Rydell, then filed an appeal with the Michigan Supreme Court. Sigma took this action more than three months after NASD had instituted these enforcement proceedings against Sigma and Rydell, and nearly three years after the customers had received their Award. The firm withdrew the appeal to the Supreme Court in connection with this settlement.

In settling these charges, Sigma and Rydell neither admitted nor denied the charges.

NASD Bars Broker For Charging Fraudulent Mark-Ups

Broker and Radio Personality John Van Defrauded Incapacitated Investor

NASD barred John Van, principal of Murphy Van Securities, Inc., of Clifton Park, NY and an upstate New York radio personality, for knowingly charging fraudulent and excessive mark-ups on Treasury Notes to a disabled customer and for making misrepresentations to the customer's attorney. Van's radio program, *The Murphy Van Financial News Hour*, was broadcast until recently on WCSS AM 1240 in Amsterdam, NY and on WENT AM 1340 in Gloversville, NY.

NASD found that in January 2004, a custodial account was opened at Murphy Van Securities, Inc., for a completely incapacitated individual in a vegetative state who had received a multi-million dollar settlement in connection with a medical malpractice lawsuit. Approximately \$3.3 million from the malpractice settlement was deposited in the custodial account.

NASD's investigation revealed that in obtaining the account, Van misrepresented to the customer's counsel that transaction fees would not exceed 1 percent. In fact, he began charging transaction fees in the form of mark-ups ranging from 2.936 percent to 3.054 percent. NASD found that Van knowingly charged fraudulent and excessive mark-ups on three U.S. Treasury Note transactions that had an aggregate value of approximately \$3.3 million. The fraudulent and excessive markups on those transactions totaled approximately \$64,000.

In settling this matter, Van neither admitted nor denied the charges.

NASD Bars Former AmSouth Broker for Fraud in the Sale of Variable Annuities

Sales Assistant Charged with Forgery and Falsification of Documents

NASD announced that James B. Moorehead of Starkville, MS, has been barred from the securities industry for engaging in fraud, forgery, and falsification of documents in connection with variable annuity sales. The transactions took place between March 2000 and April 2001 while Moorehead was a registered representative of AmSouth Investment Services, Inc.

Moorehead's sales assistant, Angela C. Wynne, has also been charged in connection with the scheme.

"The conduct of the broker in this case was reprehensible, and clearly merits the harshest penalty NASD can impose," said NASD Executive Vice President and Head of Enforcement Barry Goldsmith.

NASD found that Moorehead misrepresented the risks associated with investing in variable annuities and purposefully omitted risk disclosure statements from the performance hypotheticals his firm sent to customers. Moorehead also either forged, or caused his assistant to forge, customer signatures on 125 "Purchase Authorization Forms." These documents were intended to reflect customers' authorization to Moorehead to purchase variable annuities.

Moorehead also tried to make his variable annuity recommendations appear suitable by falsifying the suitability information on the Purchase Authorization Forms and on "Client Confidential Profiles." Moorehead directed his assistant to complete the forms with inaccurate information concerning the financial needs and condition of the customers.

In concluding this settlement, Moorehead neither admitted nor denied the charges, but consented to the entry of NASD's findings.

NASD has also filed a complaint against Moorehead's assistant, Angela C. Wynne, a general securities representative formerly associated with AmSouth. The complaint charges Wynne with forgery and falsification of documents. NASD is currently investigating the supervision of Moorehead and Wynne by AmSouth Investment Services, Inc.

Under NASD rules, an individual named in a complaint can file a response and request a hearing before an NASD disciplinary panel. Possible sanctions include a fine, order to pay restitution, censure, suspension, or bar from the securities industry.